NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.

Congressional Information Service, Inc.
Washington, D.C.

TIMBER CONTRACT ADJUSTMENTS

HEARING

BEFORE THE

SUBCOMMITTEE ON FORESTRY, WATER RESOURCES, AND ENVIRONMENT

OF THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

S. 2805

A BILL TO PROVIDE FOR THE ORDERLY TERMINATION, EXTENSION, OR MODIFICATION OF CERTAIN CONTRACTS FOR THE SALE OF FEDERAL TIMBER, AND FOR OTHER PURPOSES

AUGUST 12, 1982

Printed for the use of the
Committee on Agriculture, Nutrition, and Forestry

U.S. GOVERNMENT PRINTING OFFICE
96-286 O WASHINGTON : 1982

S/6430

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

JESSE HELMS, North Carolina, *Chairman*

BOB DOLE, Kansas
S. I. HAYAKAWA, California
RICHARD G. LUGAR, Indiana
THAD COCHRAN, Mississippi
RUDY BOSCHWITZ, Minnesota
ROGER W. JEPSEN, Iowa
PAULA HAWKINS, Florida
MARK ANDREWS, North Dakota
ORRIN G. HATCH, Utah

WALTER D. HUDDLESTON, Kentucky
PATRICK J. LEAHY, Vermont
EDWARD ZORINSKY, Nebraska
JOHN MELCHER, Montana
DAVID H. PRYOR, Arkansas
DAVID L. BOREN, Oklahoma
ALAN J. DIXON, Illinois
HOWELL HEFLIN, Alabama

GEORGE S. DUNLOP, *Chief of Staff*
J. ROBERT FRANKS, *General Counsel*
CARL P. ROSE, *Counsel and Staff Director for the Minority*

SUBCOMMITTEE ON FORESTRY, WATER RESOURCES, AND ENVIRONMENT

S. I. HAYAKAWA, California, *Chairman*

ROGER W. JEPSEN, Iowa
JOHN MELCHER, Montana

CONTENTS

	Page
Hayakawa, Hon. S. I., a U.S. Senator from California, opening statement	1
Melcher, Hon. John, a U.S. Senator from Montana	2
Pryor, Hon. David H., a U.S. Senator from Arkansas	30
Legislation under consideration:	
S. 2805, reprint of	168
S. 2289, reprint of	170

CHRONOLOGICAL LIST OF WITNESSES

Hatfield, Hon. Mark O., a U.S. Senator from Oregon	2
Peterson, Max, Chief, Forest Service, U.S. Department of Agriculture, accompanied by George Leonard, Acting Director, Timber Management, Dwight Hair, and James Perry, Office of General Counsel, Forest Service, U.S. Department of Agriculture, and Charles R. Frost, Forest Division, Bureau of Land Management, U.S. Department of the Interior	11
Kirby, Peter, coordinator, forest management program, the Wilderness Society	19
Sedjo, Roger, director, forest economics and policy program, Resources for the Future	20
Cheek, George, senior vice president for public affairs, Potlach Corporation	21
Thomas, Charles H., Jr., Shuqualak Lumber Co., Shuqualak, Miss., representing Southeastern Lumber Manufacturers Association	22
Hanke, Steve H., professor of applied economics, Johns Hopkins University	24
Resler, Rexford A., executive vice president, American Forestry Association	25
Williams, Harry, president, Southern Forest Products Association, accompanied by Clark Cosse, counsel	26
Ehinger, Paul F., executive vice president, accompanied by Richard L. Barnes, counsel, Western Resource Alliance	27
Davis, Robert L., forester, Southeastern Lumber Manufacturers Association	32
Hodges, Ralph D., executive vice president, National Forest Products Association, accompanied by John Hall, vice president, resources	36

APPENDIX

Huddleston, Hon. Walter D., a U.S. Senator from Kentucky, statement	39
Hatfield, Hon. Mark O., a U.S. Senator from Oregon, statement	40
Crowell, John B., Jr., Assistant Secretary for Natural Resources and Environment, U.S. Department of Agriculture, statement	47
Answers to questions from the committee staff	55
Kirby, Peter C., the Wilderness Society, statement	67
Letter dated August 26, 1982, to Senator Hayakawa	71
Sedjo, Roger A., Resources for the Future, statement	75
Cheek, George C., senior vice president, public affairs, Potlach Corporation, testimony of	80
Thomas, Charles H., Jr., representing Southeastern Lumber Manufacturers Association, statement	83
Resler, Rexford A., executive vice president, the American Forestry Association, statement	87
Williams, Harry, president, Southern Forest Products Association, statement	90
Ehinger, Paul K., executive vice president, Western Resource Alliance, Eugene, Oreg., statement with attached draft bill and appendixes A–E	94
Hodges, Ralph D., executive vice president of the National Forest Products Association, statement	123

Page

Hooper, John C., Sierra Club National Conservation representative, also representing the National Audubon Society, statement 129
National Association of Counties, statement 133
Schroeder, Darrell H., president, Miller Redwood Co., statement 139
Jones, Aaron U., president, Seneca Sawmill Co., Eugene, Oreg., statement 142
Hanke, Steve H., professor of applied economics, Johns Hopkins University, material supplied by 152
Reed, Starr W., Simpson Timber Co., statement 164
Liimatta, Into, director, planning and public affairs, Edward Hines Lumber Co. of Oregon, letter dated August 12, 1982, to Senator Helms 167
S. 2805, reprint of 168
S. 2289, reprint of 170

TIMBER CONTRACT ADJUSTMENTS

THURSDAY, AUGUST 12, 1982

U.S. SENATE, SUBCOMMITTEE ON FORESTRY, WATER RESOURCES, AND ENVIRONMENT, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,

Washington, D.C.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room 324, Russell Senate Office Building, Hon. S. I. Hayakawa (chairman of the subcommittee) presiding.

STATEMENT OF HON. S. I. HAYAKAWA, A U.S. SENATOR FROM CALIFORNIA

Senator HAYAKAWA. Good morning. The purpose of the hearing today is to consider Senate bill 2805.[1] This bill was introduced last week, on August 3, by Senator Mark Hatfield, of Oregon. The bill was referred jointly to the Committee on Agriculture, Nutrition, and Forestry, and we meet as the Subcommittee on Forestry, Water Resources, and Environment, and to the Committee on Energy and Natural Resources, for a period not to exceed 30 days.

Our subcommittee is Forestry, Water Resources, and Environment. We will also have it for 30 days.

Because of the possibility that the Senate will begin the August recess on the 20th of August, this committee was left with 13 working days in which to schedule full hearings and consider alternative proposals and hold markups at the subcommittee and the full committee levels. This is an extremely tight schedule for any bill, especially one surrounded by as much controversy as this one is.

Nevertheless, we are glad to have an opportunity to discuss S. 2805. I want to thank each of the witnesses for coming on such short notice.

A number of invited witnesses were unable to be here with us today for a variety of reasons, including short notice, but have expressed interest in submitting written testimony. We will hold the record open for 2 weeks and will accept additional testimony during that time.

Since we have a full slate of witnesses this morning, I will submit the remainder of my prepared testimony for the record.

I encourage all our witnesses to summarize lengthy written testimony so that we will have plenty of time for questions. We will be glad to include prepared remarks in the record.

Senator Hatfield, will you begin?

[1] See p. 168 for a reprint of S. 2805.

STATEMENT OF HON. JOHN MELCHER, A U.S. SENATOR FROM MONTANA

Senator MELCHER. Mr. Chairman, while Senator Hatfield is getting ready, I want to notify you and the committee that at the first appropriate opportunity, which may be this bill, I will offer an amendment to incorporate S. 2289.[1] S. 2289 is an amendment to remove dead, dying, diseased, and downed timber, and authorizes the Secretary to instigate such program immediately for the enhancement of the national forests in cooperation with private forest owners. The Secretary is authorized to transfer funds from other National Forest Systems accounts to carry out the provisions of the act.

It is an emergency type measure to do what we can right now to provide some opportunity for salvage of timber that is dead and dying, and the National Forest System would be enhanced if it were removed and regeneration quickly undertaken.

Senator HAYAKAWA. Is there a number on your amendment?

Senator MELCHER. Yes; S. 2289.

Senator HAYAKAWA. Thank you.

Senator MELCHER. Thank you, Mr. Chairman.

Senator HAYAKAWA. Senator Hatfield?

STATEMENT OF HON. MARK O. HATFIELD, A U.S. SENATOR FROM OREGON

Senator HATFIELD. Thank you, Mr. Chairman. I am very appreciative that you have expedited the hearing process in order to get this matter before the Senate Committee on Agriculture, and I appreciate very much this opportunity to be a witness before your committee.

I have a full statement that I would submit for the record, and I would like to briefly summarize.[2]

I would say that probably the most significant industry in my State of Oregon is the timber industry, which is represented not only by the number of jobs in our economy, but by the impact it has on the total Nation's economy. I say that because housing in my view is probably the No. 1 social problem we face in this country today, and whether we talk about poverty of the people and the needs of minorities, or whether we talk about rural poverty or urban poverty and all the other stresses in our social structure, we must come ultimately back to that common thread that weaves its way through all social policy, and that is housing, the inadequacy of housing for our people.

So I don't come here to serve the parochial interests of a Senator for his own State, but for the impact it will have on the Nation as a whole.

The question we have is why should we attempt to aid any one industry when the administration has made it clear that it is not interested in assisting industries at this particular time, but is committed to an overall economic recovery program?

---

[1] See p. 170 for a reprint of S. 2289.

[2] See p. 40 for the prepared statement of Senator Hatfield.

Let me indicate that there is something very unique about the timber industry in that the present trend in the timber industry could really in effect cripple the Nation's ultimate recovery, because in the recovery we must have housing, and the material for that housing, and very obviously if the structure, the infrastructure of the Nation that relates to the production of materials for housing is gone, or is greatly reduced, then when the day comes for the actual recovery to have been effected, we will not have the tools with which to provide our housing, which is an important part of this Nation's recovery.

Mr. Chairman, we have not only concern nationally and within the State of Oregon, but regionally. Let me indicate that out of 210 mills that operate in the State of Oregon, 70 have been closed. The State of Washington has 170 mills, and 59 have been closed.

In California, that has 116 mills, we find that 40 of them have been closed because of the problems in the economy today of high interest rates, availability of capital, and so forth.

Now, just because I have numbered these particular ones that closed, that does not mean the other ones are operating at full capacity. There is a great reduction both in time per week the mill is operating and in the scheduling of shifts.

We also recognize that the Federal Government has been a great beneficiary in the operation of the forest industry and the homebuilding industry that has been the result of that raw material. In 1979, the national forest timber receipts to the National Treasury totaled $804.7 million. In 1980, those receipts dropped to $614.6 million, and in 1981, receipts totaled only $596 million.

The figures for 1982 are not yet available, but the Forest Service estimates are that receipts will be down substantially.

So we see that the Federal Government itself has been a loser, and anything that can stimulate revenues at a time when the President is working very hard to campaign for a tax bill I think has important and significant impact on the current recovery program for the Nation as a whole.

Now, back in the 1970's, there was a great boom in homebuilding. We were at that time in excess of 2 million new starts a year. Mr. Chairman, and Senator Melcher, this has now dropped to less than 1 million new starts. During that period of time, the industry—that is, the timber-producing industry—was investing great sums of money for increasing the efficiency of operation and for fuller utilization of the raw material. As a consequence, there was also projected at that time a shortage in timber supply.

So, with high homebuilding units being started each year, with great investments for modernization, updating, new technology in the industry, there was great capital investment. During that period of time, there were many contracts made with the Federal Government which in many cases is a monopoly supplier of raw materials in the West; 51 percent of my State is owned by the Federal Government. The major supply for medium and small operators as well as some large operators in my State is from Federal ownership.

So, consequently, we had contracts being bid at high prices, and at the same time we have the new housing starts and all these other factors, it looked good.

Then the bottom fell out. As you know, these contracts are made at least 2 years in advance in order to maintain a stable supply and project that supply over a period of time. So, consequently, a number of those contracts are now coming due, but the market has dropped in the meantime.

The bottom has dropped out. We find in many comparable sales at least 44 percent less in those appraisals because, as you know, appraisals are in part tied to the market prices and the market situation.

So we find now contracts coming due, but not with performance. That is, not with the ability to perform. There is no way, absolutely no way, these contracts can be performed with the current market situation and in relation to what they bid on the prices for that timber.

Consequently, when a contract is not performable, you have one of two options. You either default on the contract, or you modify the contract.

Now, Mr. Chairman, I think it is very, very apparent that the Federal Government, unless it can move to modify contracts, will have a heavy problem of many defaulters who cannot perform the contracts. The Federal Government is going to be out. That is it, pure and simple. It is going to be out of dollars.

More importantly in some ways, the people will be out of jobs, as they are in increasing numbers. We have county and other local governments who benefit from these sales, as well, so we have, then, the impact of lesser revenues flowing into the treasuries of county and local governments, and that, of course, creates a greater impact of unemployment, and we are already decimated by depression.

That is the only way I can describe the Oregon picture, and much of the West, that we are decimated by depression today.

Since 1979, 22,000 of the 90,000 direct jobs in Oregon timber products have been lost. That is a very sizable number. Now, I am not even discussing those industries indirectly related to the timber industry which are also impacted, nor those which are directly related to the timber industry, but let me say it is far more than just the question of timber companies and those employed by those timber companies that is at stake here.

Lastly, Mr. Chairman, what I am proposing here is to give to both the Department of Interior and to the Department of Agriculture the broad authority to modify contracts. That could be termination, extension, or modification of timber sales contracts.

In other words, I do not think we should try to spell out the precise way in which contracts should be modified. I tried that in another bill, and we have yet to even get a consensus of the industry as to how we should move on that, and I feel, therefore, in order to do something while the industry tries to develop this consensus and while this administration tries to get its house in order, and get its mind made up to do something—that appalls me, too, but that is another subject—we must move ahead with some kind of assistance to the Nation, to the Nation's Treasury, to the Nation's housing needs, to the Nation's employment needs.

California, Oregon, and Washington have State-owned lands, as you know, Mr. Chairman, as a Californian. Your State, my State,

and Washington State and other States as well have State-owned forest lands. Our States have faced up to this problem. They have already moved, each of the States, either to enact legislation to modify existing timber sales contracts, or they have authorized modification of prices and extensions of contracts, or they have provided for termination without penalty. There has been a variety of legislative actions taken by the States of California, Washington, and Oregon.

We already have a track record. We already have some experience along this line. So we are not buying a pig in a poke, nor are we going blindly. We have really a very definite call for action on the part of the Federal Government.

I regret to say that today you are not going to get any more definitive response from the administration than you have gotten in the past. They can't make up their mind yet. Mr. Chairman, I really must say that I am terribly disappointed. We worked very diligently to confirm the nomination of people in the fields of timber management and timber administration in the Forest Service who have great backgrounds. These people, I know, probably must feel terribly frustrated because I am sure that the horrible shadow of OMB and a few other such agencies has probably overshadowed their desire to move ahead with some kind of substantive policy, but as yet they still are immobilized.

I use this platform today, this forum, if you please, to be very up front about it, to gig this administration into action. Even if they come out with negative results, it would be better than taking no action.

I would hope they would have the fortitude, vision, and insight to take some positive action.

You are going to hear from some of the representatives. These remarks are not in any way personal. I have high regard for them and have supported their appointments in most instances, and will continue to support them. I think they come here as people with their mouths taped over by people in higher authority in the administration, without the ability to provide helpful advice to this committee as to what might be done.

Maybe one of these days after the years of decimation of this industry, they will come to some kind of decision and come up with some kind of leadership.

It is tragic, disgusting, and disturbing that this administration has not been able to get a little more leadership in this particular field of endeavor to help in the recovery of the timber industry.

I have had my spleen vented now. I would be very happy to answer your questions.

Senator HAYAKAWA. Thank you, Senator Hatfield.

You say that already contracts have been modified by agreement between the companies and State governments?

Senator HATFIELD. Yes, in California, Washington, and Oregon.

Senator HAYAKAWA. Was the Federal Government involved in those cases?

Senator HATFIELD. No. These are State-owned lands and State-owned forests.

Senator HAYAKAWA. What happened in the State-owned lands could very well, and should, happen in the federally owned lands, too?

Senator HATFIELD. Yes, Mr. Chairman, because in the modification they have been able to maintain some degree of employment, they have been able to sustain some higher level of employment than they otherwise would have been able to do than if they had been forced to default on those State contracts.

Senator HAYAKAWA. We have 13 days left in which to consider this proposal. What do you think we can do in that 13 days? I am willing to work very hard on it.

Senator HATFIELD. Mr. Chairman, we made all kinds of foreign policy yesterday on the Senate supplemental appropriation bill. I think if we can do that with far-reaching implication, we ought to be able to do this, as a rider to some other bill, as would be appropriate.

Senator HAYAKAWA. I will be ready to work with you. You want to remove——

Senator HATFIELD. I told the chairman I would be happy to do that if he needed more time, as I did when the Senate Energy Committee asked me to do the same thing.

Senator HAYAKAWA. Senator Melcher, do you have any questions at this point?

Senator MELCHER. Yes, I have three questions.

The first two I hope Senator Hatfield can agree with. The first one would concern welcoming an amendment such as I described in my opening remarks for salvaging timber out of available funds for the enhancement of our national forests as an emergency step.

Senator HATFIELD. Senator Melcher, I have long been concerned about the failure to utilize all the tools of timber management, forest management, including salvage and all the various forms, and I have supported in the past through the Small Business Committee and other activities to get a lot of the small mills into the forest for salvage purposes. I would continue to give that support.

Let me point out, I think you have raised a very interesting additional perspective here, and that is, when we talk about timber management, whether it is salvage as a result of blowdown or other kinds of reasons, we are talking about the failure to pursue those programs as a threat to the existing forest.

We have old growth timber that comes to an age when it should be harvested. The failure to harvest that creates a threat to the other growth timber because of disease, infestation, and such things that eventually set in as it deteriorates. The same is the case with salvage.

That salvage eases a threat by fire, by infestation, by other types of things that attack the healthy growing forest.

Therefore, it seems to me it is not only an economic matter, and one to provide for greater utilization of the forest, but is also vital for the sustaining of a viable forest.

Senator MELCHER. Thank you.

This morning's article in the Post about Secretary Block selling national forest lands I hope is misconstrued by the author of the article, or at least is presumptuous. He seems to make the point of

selling not just isolated parcels, but talks about some sort of study to look at 100 and some million acres of national forest lands.

I would conclude that probably as the chairman of the Appropriations Committee, you would not be very receptive to such a wild idea of selling off the national forest lands.

Senator HATFIELD. Senator, I am not privy to the program or the plan that evidently this refers to, or may be in the making.

I would indicate that it seems to me there may well be certain tracts of forest lands that are isolated or that are scattered in such a way that effective management is very difficult, if not impossible, and that divestment of such unintegrated and isolated tracts might be very appropriate.

As to the general idea of divesting the Federal Government of its resources of the Federal forest lands, I would have to say to you that I oppose that very clearly, and I think this is the most ill-timed idea that I have heard of in a long while. If they wanted to dispose of forest lands in any way, this would be the worst time in the world to try to do so. Who would want to buy them in terms of the market? I am talking about the market situation.

I would think that there might be ways to better administer those forest lands. I have never been opposed to the idea of possibly contracting with State governments to administer them. I think the State of Oregon, for instance, has State-owned timberlands that are far better administered than any of the federally owned timberland in our State, but on the other hand as far as divestiture is concerned, that is another question. I would not be very friendly toward that idea.

Also, I think the Federal Government is failing to recognize that these are a source of money and revenue, and if they could manage them in the appropriate way I think they could realize even greater revenues from those great resources and capital investment than what they already have.

So to divest, it sounds like they are going to make more money by divestiture because that will pay off part of the national debt. I say you can make more money from those lands by holding them, and administering them and managing them in a more effective way.

Senator MELCHER. I, too, agree that only small, isolated parcels that we are talking about, anything from less than an acre up to a quarter of a section, which I believe was pretty well outlined in 1976, should be considered for either trading or selling because it is impossible to manage them well. I do not think we want to discourage that, but I would suggest that probably the Forest Service would want a great deal of guidance from Congress to go beyond that, and I would expect that both this committee and the Senate Energy Committee would be asked for such guidance.

The third question I had to ask, and which I do not expect you to entirely agree on, is that if your bill is modified so that it satisfies the interests of a broader group than has been represented in the 3 States of the contiguous 48 that border the Pacific, so modified so as to be workable with the forest products industry throughout the country, would it be acceptable and commendable on your part?

I always have to think of Senators that come from the States on the coast as having a little different perspective than some of us

whose national forest lands are not as well endowed as some you have in Oregon.

Senator HATFIELD. Senator, the bill as now proposed would apply to any Federal ownership anywhere as to a matter of modification or of contract. It is not restricted to the three Western States.

The greatest impact today on timber sales under contract happens to be in the three Western States. For instance, we have 20 million board feet under contract today in the State of Oregon and the State of Washington, those two States alone. Senator, 75 percent of those contracts are just not performable. We cannot perform under the present market situation on 75 percent of those contracts.

Now, because of the heavy Federal position, because of the monopoly that the Federal Government holds on the availability of that raw material, we are probably more deeply affected than any other States, but this authority that I seek in this bill would apply to any part of the country in which there is Federal ownership and in which there are Federal contracts.

I am just trying to avoid further massive defaults that will occur, and in those defaults the Federal Government can take those companies to court, but the cost of going to court and the inability of those companies to perform really does not get the result, that is, to get the economy back on track.

I might say very frankly that the suggestion that has been made by some other areas of the country to put a cap on, I would have to oppose that, because I don't think that is—that is more than a matter of economics. That is a matter of timber management.

I do not think you can frustrate timber management programs that must be accelerated in this country to salvage and maintain our forests.

Senator HAYAKAWA. So you propose to permit changing contracts, or cancellation wherever possible, not only in the three coastal States, but in Montana, or wherever there is timber?

Senator HATFIELD. Exactly.

Senator MELCHER. Well, I think different regions of the country, though, are concerned that the bill as moved will be helpful to those other regions.

I suspect there is a way of doing that, though we may have to blend in a variety of approaches, rather than simply using just one approach.

Senator HATFIELD. I would agree with the Senator. Back when I first proposed a remedy that was called a rollback, a rollback to current market prices, which would have affected the western part of my State. We went through a whole series of meetings and tried to develop a consensus among the industry, and we immediately got a negative reaction from east of the mountains, in the pine area, Idaho, eastern Oregon, and eastern Washington.

Senator McClure and I then got together and tried to draft up some kind of compromise that would placate all interests, in the West, particularly, and we came up with one that would provide for a partial termination, plus a road credit program.

This immediately was attacked by conservationists, environmentalists, and others, and we found again it was attacked as a regional benefit, and so I have not come up with this proposal which

seems to me the most national in scope because we don't try, Senator, to spell out one type of modification; namely, we don't try to say it should be a rollback. We don't say it should be a termination, or a partial termination. We don't say it should be any one specific thing or a combination. Let each case be handled on its own particular merits and problems and needs, and in that way we try to give a national character to this legislation, as much as possible.

Let me indicate one thing further, Senator, and that is that the regionalism in the industry is as vulcanized as it is in other industries. I don't know any industry that is more fractured than the timber industry. Even in my State, I could call a meeting of five timber operators and I probably couldn't get a consensus of more than three of the five on anything.

That is just typical of the timber industry. But I would say that while the timber industry has not been able to come together in a national interest, the Canadian timber imports are increasing. That is what is happening in this country. The Canadian timber imports are increasing all the time, filling a market that is not being filled by our own producers in this market, and the inability of the Southern pine producers, and other segments that are of this industry that is so vital to the country, as they continue to have this vulcanized mentality, we are getting more Canadian imports.

I don't know that we are going to be able to solve the problems, because the people by nature are half gambler and half adventurer to go into it. I am not trying to be critical, but analytical.

Senator MELCHER. Well, I will be critical. I think when we can watch Canadian trucks roll through Libby, Mont., or Kalispell, Mont., our people are very much aware that the Canadian system for reduction of stumpage price to keep the sawmills open and the jobs available to the workers, is very good for Canadians. But it is rather harmful for our workers.

Senator HATFIELD. That is right.

Senator MELCHER. Montana workers sit and watch as they draw their unemployment and worry about when their unemployment runs out, and what they will do about their families. They watch the trucks roll through town and don't feel very good about it. So our delegation has been besieged for the past year for Congress to take some action. We have explored during the past year what action could be taken. We are confronted with the length of time that it takes for our system to demonstrate that the Canadian policy is clearly of the nature of a subsidy. Because it is a trade policy it should be reviewed for attaching countervailing duties to that product that is imported.

When we are informed it will take probably 6 months at the best. In the meantime we continue to suffer not just a year of this going on, but it looks like we will suffer a year and a half. It brings up the point of whether a more abrupt change should be instituted in this particular bill to shortcircuit the lengthy procedure we have to provide for countervailing duties. I am sure we will want to consider that.

Senator HATFIELD. You said subsidy in reference to the Canadian program, not the Americans.

Senator Melcher. It is in effect a subsidy by the Canadians.

Senator HATFIELD. I would agree.

Senator MELCHER. And probably, therefore, an unfair trade practice.

Senator HATFIELD. I guess I am particularly sensitive that the word "subsidy" was applied to the Canadians, because proposals made like this have been superficially described as bailouts for the industry.

This is not a bailout nor was the Lugar proposal a bailout. The administration couldn't tell the difference between a loan or a bailout. This is not a bailout, or a subsidy for the industry, but rather an attempt to maintain the viability of a contract that can be performed, and this contract today cannot be performed.

Senator MELCHER. Just returning to the basic point of what the bill should include, would it be objectionable to you, Senator Hatfield, if we included in it a provision for purchaser credit?

Senator HATFIELD. I would resist that proposal on this bill. I think Senator McClure has a bill, and Senator McClure has been a strong advocate of the purchaser credit. I joined in in support earlier on, as I said. We never got into actual draft because we couldn't really get a consensus from the industry, and I bought off on that idea in order to get the cooperation and a broader support of my colleagues.

But I must say I would like to keep this bill purely to give authority and flexibility to the administrators to modify contracts without getting into the purchaser credit.

I think there will be other opportunities and vehicles for that topic at a later time.

Senator HAYAKAWA. May I say a word to my colleagues? As you know, Senator Hatfield and Senator Melcher, I am leaving the Senate at the end of my term this year. Senator Hatfield presents something of a challenge here in getting things done right away on this, because it is a desperate situation for your States, for Oregon and my State, and for Montana, Idaho, and other States as well.

I would like to get something done on this before I leave, and I want to offer my assistance to you, Senator Melcher, and to you, Senator Hatfield, and see if the three of us could work out something that we can get done.

Senator HATFIELD. I would be happy to make it a Hayakawa bill, to make it a great monument to you in the Senate.

Thank you, Mr. Chairman.

Senator HAYAKAWA. Thank you, Senator Hatfield.

I would like to hear next from the panel from the Forest Service, Max Peterson, Chief, Forest Service, U.S. Department of Agriculture; George Leonard, Acting Director, Timber Management, and Dwight Hair, U.S. Forest Service, U.S. Department of Agriculture, and Charles R. Frost, Forestry Division, Bureau of Land Management, U.S. Department of the Interior.

STATEMENT OF MAX PETERSON, CHIEF, FOREST SERVICE, U.S. DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY GEORGE LEONARD, ACTING DIRECTOR, TIMBER MANAGEMENT, DWIGHT HAIR, AND JAMES PERRY, OFFICE OF GENERAL COUNSEL, FOREST SERVICE, U.S. DEPARTMENT OF AGRICULTURE, AND CHARLES R. FROST, FOREST DIVISION, BUREAU OF LAND MANAGEMENT, U.S. DEPARTMENT OF THE INTERIOR

Mr. PETERSON. We are all here, Mr. Chairman, except George Leonard, who is serving on the House side, and who will be here shortly.

Senator HAYAKAWA. I see. All right. You don't have prepared statements to make, I understand.

Mr. PETERSON. No, we do not.

I might introduce to you Dwight Hair on my left, Jim Perry, from our Office of General Counsel, is next, and Chuck Frost from the Bureau of Land Management.

Senator HAYAKAWA. Is that Mr. Perry?

Mr. PETERSON. Perry, P-e-r-r-y.

Senator HAYAKAWA. That is, Mr. Peterson, Mr. Hair, Mr. Perry, and Mr. Frost. I have a cluster of questions here. You can answer them later if you don't have figures here to answer them now.

Mr. PETERSON. Mr. Chairman, might I say that we appreciate the opportunity to be here today. The adverse economic situation in the forest industry is very difficult and complex, and one whose solution requires great efforts, and we assure you of our cooperation.

The administration position on S. 2805 is still under consideration. My colleagues and I are now available to you as technical witnesses. We expect an administration position will be available early next week, and we will get it to you as early as it is available.[1]

Senator HAYAKAWA. The administration has not made a formal statement on it yet?

Mr. PETERSON. That is correct.

Senator HAYAKAWA. Who would be the primary beneficiaries of a proposal such as S. 2805, or any other program that allows the termination or modification of existing timber contracts?

Mr. PETERSON. National forest and public land timber purchasers holding high-priced contracts which cannot be economically operated under current and foreseeable market conditions. In terms of who would take advantage of it, that is somewhat speculative, and it depends on the individual situation and the individual purchaser. In terms of volume, about 60 percent of the volume would probably be in the three States, California, Washington, and Oregon.

But I think that it would be used elsewhere as well. It could be important to individual purchasers who don't have very much volume.

Senator HAYAKAWA. When I say who will be the primary beneficiaries, presumably if the compromises and modifications of contracts are well drawn up, both the Government and the contractor will benefit from the compromise, will they not?

---

[1] See p. 47 for the prepared statement of Assistant Secretary Crowell, which contains the administration's views, and p. 55 for answers by Mr. Peterson of questions asked by the subcommittee subsequent to the hearing.

Mr. PETERSON. Mr. Chairman, I think that if there is a major attempt, which I would expect, in connection with the administration of legislation like S. 2805, there would be an attempt to try to see that there was orderly flow of material into the market so that hopefully there would be more employment and so on.

I might point out, though, that as long as demand remains low, we can't really influence the total amount that is going to the market very much by changes on the supply side.

It only changes who might participate. It may have some effect on imports, but it really won't change the total amount that is going into the market as long as demand remains low. The ultimate cure for this problem is a pickup in demand.

Senator HAYAWAKA. If the supply increases, doesn't the price go down?

Mr. PETERSON. Yes. You might increase demand marginally, but because——

Senator HAYAKAWA. Lower prices would not increase demand to a huge degree?

Mr. PETERSON. Not to a huge degree. Because of the interrelationship between lumber and the housing in the United States, there would have to be an increase in housing.

So interest rates would be a key to this.

Senator HAYAKAWA. I understand.

Mr. PETERSON. And an economic recovery.

Senator HAYAKAWA. And if terminations or modifications of existing contracts cannot be provided, then what happens? Perhaps a continuation of the present stalemate?

Mr. PETERSON. I think what will happen is that many contracts will continue to be held. Some companies will mix higher priced contracts and lower priced contracts and be able to move the timber. Our analysis of the situation is that probably about 6 billion feet of the amount under contract in the Far West would not move even under the highest markets that we have experienced in recent history.

So it would take a considerable improvement in the market to move that 6 billion feet, unless the companies operated at a loss.

Senator HAYAKAWA. Are there any alternatives to the termination of these timber contracts, or the modification of present terms?

Mr. PETERSON. Yes, there are a number of alternatives. We have evaluated more alternatives in the past 2 months than I thought existed. There are alternatives such as contract term adjustments, which leaves the contracts in place but extends the time for their performance without penalty, which means the person would still have a contract, and they would be expected to perform it, but they would have the additional time within which to perform it. That is something that does not require termination of the contract.

Senator HAYAKAWA. Yes.

Mr. PETERSON. There would be a possibility that this time would allow a mixing of more modestly priced timber with higher priced timber to bring into the market. That is one major thing.

There could be an extension of contracts, which we have already done administratively, but which currently requires either partial payments or payments of interest, so that is one that costs the pur-

chaser money, but still leaves the contract in place. Those are two of the alternatives, and there are another six or eight that we have looked at.

Senator HAYAKAWA. The rest of you are invited to take part in the discussion, too.

Some analysts, industry analysts, have proposed that the current market downturn may thus merely move up the date when some of the mill capacity in the Pacific Northwest may close. Would you agree with this assessment?

Mr. PETERSON. There are always, in any industry, companies expanding, others being formed, and others going out. So that process is a continuing process. I think what you would say about the present situation is that it would certainly accelerate companies going out at a much greater rate than would happen under a normal situation.

Maybe Dwight Hair, our economist, would like to comment.

Mr. HAIR. I don't think I can add anything, Mr. Chairman. I think the Chief has described the situation very well.

Senator HAYAKAWA. As long as the market stays down and continues to go down, the mill capacity will also diminish?

Mr. PETERSON. Yes; eventually mill capacity has to match the demand, and whether mills can make it through this very low demand situation to better markets, of course, depends on how long it lasts. Many of us expected the upturn to occur before now.

Senator HAYAKAWA. What about the timber supply situation, and I am thinking in long-range terms.

Mr. PETERSON. For the United States as a whole?

Senator HAYAKAWA. Yes.

Mr. PETERSON. Well, the United States as a whole——

Senator HAYAKAWA. As far as the three Western States are concerned.

Mr. PETERSON. The three Western States have a somewhat different supply situation than the rest of the country, as Senator Hatfield has indicated already. A large percentage of the forest land in the three Western States is federally owned.

The private lands in the Pacific Northwest, many of those have been cut over in the last 50 years, and have not yet—reforestation has not yet grown to the point where they are available for as much harvest as they were before. Therefore, there is a very tight timber supply situation in the Pacific Northwest, and it will remain fairly tight for the foreseeable future, depending, of course, on how much is sold from the public lands.

Senator HAYAKAWA. Is it true that even though the Forest Service has reduced the prices, the bid rates in these particular areas are still several times higher than the appraised price, and the sales are actively purchased?

Mr. PETERSON. It is true that sales are actively purchased. Both appraised and bid prices have come down. Bid prices are following much closer to our appraised price. Nevertheless, bidding continues to raise prices significantly above our appraised prices.

Senator HAYAKAWA. How are physical sales in 1983 above 12.3 billion board feet? How would that affect timber sales, for example, in western Oregon?

98-286 O - 82 - 2

Mr. PETERSON. That level in the present budget for 1983 would hold timber sales about the same in California, Oregon, and Washington, and about the same as they have been in recent years.

Those sales levels are important from the standpoint, with a lot of timber under contract that is economically unavailable, it is important to have timber under contract that is economically viable. We have made some short-duration sales in accessible areas, so that they would be reasonably accessible to the market within a short time.

Senator HAYAKAWA. One proposal that has been advanced is to grant to a group of firms the ineffective purchaser road credits, so-called. What does that mean? That dates back to 1975 public timber subsidies.

Mr. PETERSON. Let me explain what that is, without putting adjectives on it.

Senator HAYAKAWA. Please explain it.

Mr. PETERSON. When we sell timber, we determine the appraised price based on the selling price of lumber and working backward on the costs that are involved.

Some sales will not allow financing the entire road costs within the first sale, and still pay what we call the base rate, which is an amount below which we will not sell—in other words, the minimum or cash price, plus deposits for Knutson-Vandenburg purposes, which is for reforestation, and so forth.

Let me give you a typical situation. You might have a sale that appraises at $90. Maybe the road costs are $80. That gives you $10, but you might have $12 to $15 of sale area betterment, and thus our base rate might be $15, which means all the purchaser could get for building the road is $75, rather than the $80 as we appraised the road costs to be.

That means he has a choice of either not bidding on the sale, or building a road that costs $80 and getting $75 back. The proposal would be to transfer that $5 to another sale, which means he would recover that extra $5 on another sale. That is what a transfer of ineffective purchaser credit means.

It gets more complicated when you put index prices in it, because what you think is effective purchase credit when you enter into a contract may change as the index changes.

Therefore, that $5 that you thought was ineffective might turn out to be $30.

Now, I do not feel that there would be a change in the timber sales that we would make, if this procedure were adopted. I think that argument is somewhat questionable, because the sales we make are based on land management plans.

Since there would have to be a sale to transfer to, that does have positive values. In the real world, it would probably allow a transfer of purchaser credit from, say, a salvage sale that didn't have much value in it to a green sale. I think the more difficult issue in this whole purchaser credit transfer is the retroactive question, as to whether or not that changes the basis of the bidding that was originally there when they bought the sale.

That is one of the issues. That is a description of what the situation is. I do not personally see it as being considered a subsidy, because the person is only getting back our engineer's estimates of

the cost of building the road. A permanent road is left in place for the public.

Senator HAYAKAWA. Senator Melcher, do you have some questions?

Senator MELCHER. Thank you, Mr. Chairman.

First of all almost every component of our economy is going to need some special help to survive in these very desperate economic times. We are talking today about the forest products industry. Forest products are extremely important to my State and to Chairman Hayakawa's State, and Senator Hatfield's State, as well as many others.

Of course, this bill is designed to try to help the industry, but it seems rather narrow from my viewpoint, as to the portion of the industry that it would help.

Lower interest rates are the key part that not only would help this industry, the forest products industry, but would help all industries in the United States.

Now, whether or not we in Congress can deliver some help in that regard this year remains to be seen. I hope that we can, and we can assure you gentlemen from the Forest Service that we do have plans to address that very problem before the next month is out. Hopefully we will take constructive steps to reduce interest rates.

The reason I say that this particular bill seems to me to be drafted to only help a very narrow portion of the industry is that we read some statements by people in the industry that say that 80 percent of the advantage of this bill would probably affect companies in Washington and Oregon. I presume, Senator Hayakawa, that perhaps some companies in northern California would be benefited along with those in Oregon and Washington, more so than would the balance of the industry throughout the rest of the country.

So, I think it will be our purpose to try to come up with a better balanced bill, and indeed to move it.

I note that the National Forest Products Association discusses in their testimony, that will be given later today, on page 4, the average per thousand board feet sale price in the Northwest for Douglas fir. It rose in 1970 from $41.90 per thousand board feet to $432.20 per thousand board feet in 1980. That is a 931-percent increase.

Would it be true, Max, that the effect of this bill would be disproportionate, being more of benefit to the Pacific Northwest by far than to other regions of the country?

Mr. PETERSON. I think as far as Forest Service and the Bureau of Land Management are concerned, we sell more timber in those three States than we do elsewhere.

In other words, we regularly sell about 60 percent of our volume there, and that is where we have the bulk of our timber under contract.

So from that standpoint, that is where the problem is. You are going to find that the solution hits heavier there, where the problem is.

Now, I would expect some companies in Montana and Idaho to take advantage of the provisions should this bill be enacted. As you

know, I believe, there is an index in operation on the east side of Oregon, Washington, Montana, and Idaho which does index the selling price of lumber, index logs to the selling price of lumber, so there is some reduction of the price that has taken place in Idaho and Montana.

Those indexes are not in place on the west side, in California, Oregon, and Washington.

Senator MELCHER. Would there be other areas of national forest lands where average contract prices rose to as high as $432 per thousand board feet?

Mr. PETERSON. There would be a few places of high quality hardwood that would be higher than that, but as far as soft woods are concerned, Pacific Northwest prices are the highest.

Senator MELCHER. These hardwood contracts, are they in jeopardy right now?

Mr. PETERSON. Not very many that I am aware of.

Senator MELCHER. So the bill is really designed for softwoods, principally?

Mr. PETERSON. Most of our sales are in softwoods, yes.

Senator MELCHER. We have been using a figure, and I don't know whether it is accurate. Perhaps you can advise me. About 40 percent of the sale of softwood lumber in the United States is of Canadian origin. Is that correct?

Mr. HAIR. Last year, Senator, it was about 30 percent.

Senator Melcher. Was it going up at the end of the year?

Mr. HAIR. I don't have the data available for the end of the year. We do have the data for the first 4 months of this year.

Senator MELCHER. What was that data?

Mr. HAIR. It was down 30 percent.

Senator MELCHER. So Canadian lumber imports would be down in the range of 20-something percent?

Mr. PETERSON. Since the total consumption in this country has dropped, the percentage might stay fairly close, the percentage of consumption.

Mr. HAIR. Total consumption is down about 30 percent, also, so you would have roughly a proportionate change.

Senator MELCHER. So in this tough market where not much is being sold, about 30 percent of the softwood is Canadian?

Mr. HAIR. That is correct, sir.

Senator MELCHER. What involvement did the Department have in the determination by Mr. Brock's International Trade Commission on whether or not this is an unfair trading practice?

Mr. PETERSON. We provided data to the International Trade Commission on prices in the United States that are bid for national forest timber and what the price makeup is. We provided all kinds of data to the Commission.

The Commission itself obtained similar data from Canada and made their own judgment.

Senator MELCHER. We have some pending contracts with an average price of $432 for Douglas fir in 1980. What would be the comparable stumpage price of crown timber in Canada where this Canadian lumber is coming from?

Mr. PETERSON. We have some average prices over time. In 1979, for example, British Columbia prices were about half the U.S.

price, $60 versus $127. You can find a few places where the stumpage in British Columbia may be as low as about one-sixth of U.S. prices. That is the price of stumpage.

Now, if you go to the price of logs, though, the prices are much closer. For example, delivered wood in the United States was $173 for logs and in Canada, $146. So the difference was $27.

One of the factors that the International Trade Commission pointed out is that the changing exchange rate between the United States and Canada between 1972 and 1981. In 1972, a Canadian dollar was $1.01, compared to ours, and in 1981 it was 83 cents. So you see, that changes the mix considerably.

So one of the reasons for the increase from Canada is the increase in the value of the U.S. dollar.

Senator MELCHER. Most of the forest products I hear about and see on trucks or on railroad cars from Canada to the United States is softwood lumber. It is not logs. So I think we are dealing principally with dimensional lumber. Do you have anything for 1981 or 1982 on what Candian stumpage costs are?

Mr. PETERSON. If you start with stumpage in Canada, one of the great difficulties is that our stumpage is computed as if the roads were in place. That is the gross stumpage price.

The Canadian price differs in that the companies must build the roads on top of paying the stumpage. They must also do quite a lot of other things in the same area.

So the net stumpage tends to be like $28, in that range, but on top of that, what the Canadian companies have to do is quite different from what the U.S. companies have to do.

Canadian timber is also sold at an appraised price, not on a competitive bid basis. So there is none of this bidding up as occurred in the Pacific Northwest in the last couple of years. That does not occur in Canada, because they are talking about long-term contracts in which they adjust the appraised price. It is not competitive bids.

Senator MELCHER. Well, since Mr. Brock's ITC will be looking at the data from both sides, from Canada as well as the United States, I am trying to ascertain whether the data you are providing will be current.

Mr. PETERSON. Yes; it would, as current as possible.

Senator MELCHER. I wouldn't call 1979 current.

Mr. PETERSON. I also have 1981 costs.

Senator MELCHER. And that will be supplied to him?

Mr. PETERSON. Yes.

Senator HAYAKAWA. Would you provide that to the Senator?

Mr. PETERSON. We will be glad to supply you with a copy of the International Trade Commission report. You may have that already.

Senator MELCHER. I think we do.

Now, going to roads and going to a different slant on what we need to do to help industry, both management and workers. If we attach a provision to this bill, or to a bill that is passed by October 1, to provide for salvage work and for thinning, et cetera, and financed or paid for out of the authorized funds already available to the Department, allowing transfer of funds that are available, what funds do you have right now? You can't do much in timber sales.

In Missoula, region 1 headquarters, I am constantly reminded by unemployed sawmill workers and unemployed loggers that unemployment has surged to 30 percent in the mills and probably it is fair to say 60 percent in logging. They also remind me that Forest Service employees in region 1 have been cut back only slightly. These unemployed workers wonder whether there is not work that they could perform that would be helpful to the Forest Service in terms of salvage and thinning, without additional funds

We are not in a position, as you well understand, of any additional appropriations. We are looking at appropriations and money contemplated to be appropriated in fiscal 1983 for the Forest Service in an attempt to do some of the emergency work of this nature.

I am asking you Max, from a practical standpoint, whether there are funds to be transferred for this purpose.

Mr. PETERSON. We sent, or I sent, a letter to all our regional foresters about 3 weeks ago suggesting that they take an up-to-date look at what is selling in the region. In some cases, there is still a market for chips, or a market for firewood. I asked them to look at program adjustments that would put people to work in preparing sales that would sell.

The big problem is that there is not much point preparing a lot of sales that would not sell. We are right now and have been moving for several weeks now to look at salvage sales. If they are moving, let's move those. If chips are moving, let's move those, and if firewood is moving, let's move that, and try to beef up what we are doing to match the market.

We are doing that right now.

Senator MELCHER. I think this would give you added flexibility. Thank you very much.

Senator HAYAKAWA. We have 10 more witnesses to hear, and we have only 1 hour and 8 minutes in which to hear them. So we will have to be very careful of our time.

Also, it would be my observation over many, many years of sitting at meetings that the mind can absorb as much as the rear end will take. I would like to declare a 5-minute recess. We will be back here at 3 minutes to 11 and continue our hearing.

[Recess taken.].

Senator HAYAKAWA. Let's liven things up a little bit here. There are still 10 people to be heard. I am going to list them all, and I am going to ask these 10 to sit around this table. They are Ralph D. Hodges, executive vice president, National Forest Products Association; John Hall, vice president, Resources, National Forest Products Association; Steve H. Hanke, professor of applied economics, Johns Hopkins University; Rexford A. Resler, executive vice president, The American Forestry Association; Rodger Sedjo, director, forest economics and policy program, Resources for the Future; Paul F. Ehinger, executive vice president, Western Resource Alliance; Richard L. Barnes, counsel, Western Resource Alliance; George Cheek, senior vice president for Public Affairs, Potlatch Corp.

Mr. Hanke, weren't you formerly with the Council of Economic Advisors?

Mr. HANKE. Yes, I was.

Senator HAYAKAWA. Please sit down.

Then, we have Charles H. Thomas, Jr., Shuqualak Lumber Company, Shuqualak, Miss., representing the Southeastern Lumber Manufacturers Association; Robert L. Davis, forester, Southeastern Lumber Manufacturers Association; Harry Williams, president, Southern Forestry Products Association; Clark Cosse, counsel, Southern Forestry Products Association; Peter Kirby, coordinator for forest management program, the Wilderness Society, and John Hooper, public land specialist, the Sierra Club.

Now, instead of giving formal papers, which we really haven't got time to do, and I have prepared documents from all of you, and your documents that you have directed to the proceedings of this subcommittee. So you understand that what you have had prepared will go into the permanent record.

What I would like to propose is that all of you here have heard the discussion up to this point, and all of you have in one way or another some comments, supportive or critical, to make about some of the things that have been said here, and this let's us have just a general discussion back and forth.

Anyone raising a hand is welcome to speak. Try not to give a half-hour oration. Give everybody else a chance to speak, and let's exchange views and, as you speak, please identify yourselves and your affilitation.

Mr. Hooper, why don't you start out for the Sierra Club?

Mr. KIRBY. Mr. Chairman, Mr. Hooper is not here at the moment. He will be here shortly.

Senator HAYAKAWA. What is your name?

Mr. KIRBY. My name is Peter Kirby. I will be brief.

Senator HAYAKAWA. You are with the Wilderness Society?

Mr. KIRBY. Yes. As you suggest, I will be as brief as possible.[1]

Senator HAYAKAWA. All right.

STATEMENT OF PETER KIRBY, COORDINATOR, FOREST MANAGEMENT PROGRAM, THE WILDERNESS SOCIETY

Mr. KIRBY. Conservation groups do support legislation to provide contract termination as the most appropriate relief.

Senator HAYAKAWA. Contract termination rather than renegotiation?

Mr. KIRBY. That's correct. We think it is the most appropriate relief for timber companies and communities sorely stressed by the current economic situation.

We have no objection in principle to legislation allowing for the termination of existing contracts providing that needed safeguards insure that the relief is economically sound and environmentally responsible.

What we would like to do today is make three suggestions about how this legislation can be improved to make it more environmentally sound and economically responsible.

Senator HAYAKAWA. Go ahead.

Mr. KIRBY. With your permission, I will list the three.

Senator HAYAKAWA. Please do that. That is just great. Thank you.

---

[1] See p. 67 for the prepared statement of Mr. Kirby.

Mr. KIRBY. The first suggestion we would make is that there should be a forest-by-forest moratorium on new timber sales in roadless areas, until——

Senator HAYAKAWA. Say that again?

Mr. KIRBY. There should be a forest-by-forest moratorium on new timber sales in roadless areas until terminated sales from roaded areas can be reoffered.

Let me explain why this makes economic and environmental sense. If sales have already been offered and purchased, and those are terminated, those should be reoffered first because of the obvious administrative savings in doing surveys and environmental studies. There is that economic advantage.

Then, there is the environmental advantage of not having to build as many roads to access brandnew sales in roadless areas when there are already sales to be carried out in roaded areas.

So, there are economic as well as environmental advantages.

Secondly, contract terminations should be the exclusive remedy for uneconomic contracts, not further contract extensions or price reductions.

Senator HAYAKAWA. OK.

Mr. KIRBY. Contract terminations, it appears to us, remedy the problems identified. Companies are let out of contracts, and therefore do not face defaults. Plus, when the contracts are resold, they will be resold at current market prices and therefore will be economic and allow logging.

However, extensions in price reductions will reward the companies that speculatively bid in the late 1970's, because they are able to hold on to those contracts and eventually profit from them in case of extensions or price reductions.

So in terms of the public policy against encouraging speculation, it is desirable to have contract terminations, not extensions.

Lastly, Mr. Chairman, conservation groups strongly oppose any provision to add road credit subsidies to this bill.

Senator HAYAKAWA. Add what?

Mr. KIRBY. Road credit subsidies to this bill. There was a line of questioning before this earlier between Senator Melcher and Senator Hatfield. We strongly endorse the statement of Senator Hatfield that this should not be added on.

In the testimony, we list our particular objections to it.

Senator HAYAKAWA. Thank you. Does someone want to defend the idea of renegotiating the contracts?

STATEMENT OF ROGER SEDJO, DIRECTOR, FOREST ECONOMICS AND POLICY PROGRAM, RESOURCES FOR THE FUTURE

Mr. SEDJO. My name is Roger Sedjo.[1] I am director of the forest economics and policy program, Resources for the Future. However, I speak on my own behalf, and not the organization.

What I would like to point out are some of the difficulties with the termination concept. Let me first point out that some of the difficulties that have arisen here are an outgrowth of the problems of the 1970's. The increasing inflation that generated a flight from

[1] See p. 75 for the prepared statement of Mr. Sedjo.

financial assets into real assets, one of those was timber, and so in that environment of the 1970's timber prices and bidding prices on these kinds of contracts were bid to levels that are not sustainable in the current situation of disinflation.

The question is: How do you deal with this? On the one hand, the situation has been created largely by, if you will allow me, by failure of governmental policy, Government monetary and fiscal policy, and stabilization policy. So the firms were caught in a situation, in an environment, that encouraged that kind of behavior.

On the other hand, so was every other firm in the economy, and so were a whole host of home buyers, land buyers, agriculturists, and investors of all types. They were caught in the same kind of environment. So the notion of terminating contracts in this context for some subset of a whole host of citizens and economic agents who got locked into contracts in those unique times raises some fundamental questions.

There are really two fundamental kinds of problems. When you terminate the contract, somebody gains, but somebody loses. OK, who would lose in the case of the termination of the Forest Service timber contracts? Bob Wolf of the Congressional Research Service estimated that the Treasury would lose some $2 billion if those contracts were terminated, based upon a proposal for 40 percent termination that was under discussion.

So we are talking about up to $2 billion lost to the Treasury, that is, the U.S. taxpayers.

Associated with this is the structure of the forest products industry. Clearly, the reason that the industry has not been able to come up with a definitive position on this is because termination is going to affect the terms so very differently. It is going to affect firms differently and regions differently. So a decision to terminate is going to impact on the entire structure of the industry and the relative competitive positions of those firms.

Now, I should make a couple of additional points.

Senator HAYAKAWA. Watch your time, now.

Mr. SEDJO. All right. Two minutes.

It has been maintained that this is going to help the industry. I think there is a real question there. Basically, the provision is going to help specific firms within the industry. The industry as a whole is going to be impacted, but the impact will be variable.

The real problem, as pointed out earlier, is the fundamental lack of demand in the economy. If the housing recession continues for 2 more years, the industry is in big trouble, regardless of termination or not. Termination is small potatos in terms of the big picture and it is specifically focused at particular firms.

Thank you.

Mr. CHEEK. Mr. Chairman?

Senator HAYAKAWA. You are George Cheek?

STATEMENT OF GEORGE CHEEK, SENIOR VICE PRESIDENT FOR PUBLIC AFFAIRS, POTLACH CORP.

Mr. CHEEK. Yes, of the Potlatch Corp. We are in San Francisco.[1]

[1] See p. 80 for the prepared statement of Mr. Cheek.

I would like to amplify the remarks of the last speaker. In just three areas, that is. My company feels that termination and price modification, which we believe is just another name for rollback, would be very negative to us and to many other companies in the industry, for a couple of reasons.

One is bias. Senator Melcher referred to this, that 80 percent was the figure he used, of the benefits would go to the Douglas fir region, which is just the coasts of Washington, Oregon, and California, but mostly in Oregon, we feel.

The Congressional Research study said 65 percent. Another estimate was 81 percent. But whatever the estimate, the benefits would be largely loaded into that area of the country.

The second one is cost. There has been a great deal of talk about cost, and the figure of $2.6 billion was in the Congressional Research Service study, and the Forest Service estimated at $1.3 billion. Obviously, it won't be the entire cost. That is the cap, the top. But you are still talking about a great deal of money, and if an industry is forgiven debts of $1 billion, is that very different than giving $1 billion to Lockheed or some other company?

My company is opposed to termination in the form proposed and in price modification. Contract term adjustments we think is a different thing entirely. It is different from contract extension. There seems to be some confusion in some of the statements that have been made or submitted. But contract term adjustment would simply give the companies that have these high-priced contracts a breathing space in which to give the market an opportunity to recover.

We think that probably in equity that would be a good thing to do. That is the one feature of the bill we think we could support.

Senator HAYAKAWA. Thank you. It gives you an extra 5 years or 10 years?

Mr. CHEEK. Whatever the Senate decides to have. If 3 to 5 years is initially given and if this situation goes on, God forbid, then the term could be adjusted further.

Senator HAYAKAWA. Yes, sir?

STATEMENT OF CHARLES H. THOMAS, JR., SHUQUALAK LUMBER CO., SHUQUALAK, MISS., REPRESENTING SOUTHEASTERN LUMBER MANUFACTURERS ASSOCIATION

Mr. THOMAS. I am Charles Thomas, from Shuqualak Lumber Co. Part of my statement will be repetition, but it will be quick.[1]

I believe that any legislation providing for termination or term adjustment or price modification cannot be made equitable for all regions. It is impossible to do it.

I would like to make some brief statements, and present a few facts I accumulated before I came here. The Northwest purchases timber for an average price of 20 percent of what they paid in 1980. The price is down 80 percent.

According to the U.S. Forest Service monthly field monitoring reports, for the calendar year 1980, region 6, the Northwest paid $306 per thousand average price, according to this report. In July 1982,

[1] See p. 83 for the prepared statement of Mr. Thomas.

they paid $62. In June, they paid $79.58, according to the U.S. Forest Service figures.

Our firm is having to pay 70 to 85 percent of what we paid in 1980 for U.S. Forest Service timber, sir.

I have been in contact with mills in Idaho and the east side of Oregon. Here are the prices paid for Forest Service timber from two mills in that area for the first 6 calendar months of this year. One mill paid $2 per thousand. One mill paid $37 per thousand, for all U.S. Forest Service timber purchased in the first 6 months of this year.

We have run into one other basic problem. When we get from region to region, being equitable, these mills reported to me that their overruns or small logs—that means that when they get a log in then they get lumber, they reported to me that they are getting an average of 48 to 58 percent more lumber than for what the log is scaled by U.S. Forest Service.

U.S. Forest Service tells us in our region, which is region 8, that if we could obtain 15 percent overrun, we would be doing wonderfully. So there is a complete variation in scaling practices between the two regions, that in my opinion, needs some work done on it.

Now, the crux of my remarks is that in view of the extremely low timber prices at which Western manufacturers can purchase U.S. Government timber now and the vast difference in scaling practices, Western wood lumber manufacturers are now delivering lumber into Memphis, Tenn., which we consider our market, with a $66 to $85 per thousand railroad freight rate, we have a $7.50 freight rate into Memphis, Tenn., they are delivering lumber into Memphis at $48 per thousand less than we can sell it for.

Now, these are the inadequacies and inequities that are occurring right now.

A Memphis paper dated August 5, and this is the Commercial Appeal, stated, "Western wood lumber manufacturers come out after 85 percent of log capacity." If this is true or not, I don't know, but it is certainly in the Commercial Appeal.

What is so changed in the lumber demand to put these folks at 85 percent capacity? The low prices and scaling practices.

According to the latest newsletter from Western Wood Products Association, WWPA, Western wood lumber manufacturers have shipped more lumber into the South the first 6 months of this year than in any year since 1970, and this is according to their own paper.

We in the South have been very concerned with the dramatic increase in Canadian lumber importation and I won't get into that as we have discussed it. We figure about 30 to 38 percent of the lumber in the United States is now coming from Canada. That is far enough on that.

But we have not only been losing our lumber markets to Canadian lumber, but to Western wood lumber manufacturers because of low timber prices and different scaling practices afforded to Western wood lumber manufacturers by U.S. Forest Service, and I will consider any relief legislation as a further direct subsidy to Western lumber manufacturers.

I will be glad to answer any questions.

Senator HAYAKAWA. Thank you very much.

You have just broken my heart.

Mr. THOMAS. I am sorry, sir.

Senator HAYAKAWA. I would like to hear from Steve Hanke, representing an academic point of view.[1]

STATEMENT OF STEVE H. HANKE, PROFESSOR OF APPLIED ECONOMICS, JOHNS HOPKINS UNIVERSITY

Mr. HANKE. Mr. Chairman, thank you. I note your preference for concision, and since I can write more efficiently than I can speak, I will read my little statement. I think that will save us time.

As we all know, before we can determine our preferences for a particular policy, we must know its full consequences. Today, I will address the income tax consequences of the price rollback or contract termination provisions of the so-called timber bailout.

In my view, the income tax consequences of price rollbacks and terminations are complex and, to my knowledge, have not been dealt with, even in the trade press. Tax consequences will greatly reduce the costs to the Government of a timber bailout, while at the same time they will reduce the benefits to the industry of the bailout.

For example, my analysis of a bailout proposal that would allow for 40 percent of the existing U.S. Forest Service and Bureau of Land Management timber contracts to be terminated is the following:

The cost to the Government, in lost penalties, would be between $1.5 and $2 billion.

The income tax cost to the industry, in back taxes, would be $1.3 billion. So, in fact, we are putting it into one pocket and taking it out of the other.

Briefly, the reasoning that supports my analysis is as follows: Contract prices, or more precisely bid prices for futures contracts, are used at the time the contracts are made to value stumpage that is cut in the year the contracts are made. If these contracts are terminated or their prices rolled back, then the valuations of past stumpage cut must be reduced. This will reduce the past income from cutting stumpage, which is taxed at a capital gains rate.

However, it will also increase the past income from processing this stumpage, since its value will have been reduced. The net result will be to expose less income to low capital gains rates and more to higher ordinary income tax rates in past years. For the years that I considered, 1977-80, every dollar in price rollbacks or terminations would cost the industry 18 cents—ordinary income tax rate equals 48 percent; capital gains tax rate equals 30 percent. To obtain the total cost in back taxes, all we do is determine the dollar difference between the original contract price, which was used for stumpage valuation, and the new price. Then multiply this difference by 0.18 and, last, multiply the answer by the volumes of stumpage that had been valued originally at the high contract price.

Senator, in conclusion, I would simply point out that this very complex issue of perhaps great exposure to past income taxes has

[1] See p. 152 for additional material supplied by Professor Hanke.

to be factored into your considerations when dealing with this termination or price rollback provision, and it is not clear at all whether the industry, in fact, is going to gain anything by this particular bill.

Senator HAYAKAWA. Thank you. Thank you very much. That is something I had not thought of.

STATEMENT OF REXFORD A. RESLER, EXECUTIVE VICE PRESIDENT, AMERICAN FORESTRY ASSOCIATION

Mr. RESLER. Mr. Chairman, I am Rex Resler, of the American Forestry Association.[1] I want to make it clear that AFA is also a conservation organization, and I am sure Peter will not object to our speaking for ourselves.

I would like to point out something that is kind of a generic problem. Senator Hatfield's bill would provide broad authority to the Secretary of Agriculture and the Secretary of the Interior to make decisions on how best to handle these matters.

The logic for supporting S. 2805 is that it may be the only way relief can be gotten through this session of Congress, because it might be attached as a rider to another bill and therefore avoid a veto.

What that process does is suggest that the Secretaries of Agriculture and the Interior, and particularly the agency heads, would then be responsible for acting as Solomon to try to resolve the differences that are clearly represented around this table.

I submit that the preferable approach would be to have very explicit language in legislation which would direct the Secretaries how to resolve the problems associated with contract arrangements once they have been entered into by buyer and seller. I am convinced that the Federal Government has been partially responsible for the runaway competitive bidding in the Pacific Northwest.

Senator HAYAKAWA. The Federal Government has?

Mr. RESLER. Yes; because the appropriations needed to offer the full sustained yield capacity for sale has been slighted historically, over successive administrations. My statement develops a few other connections that lead me to believe that the Federal Government is not without some responsibility.

My key point is that if there is a legislative solution, and we believe there should be, I would prefer to see it accomplished by rather explicit language, rather than deferring to the judgments of the Secretaries of Agriculture and the Interior.

The process the agencies would have to go through would be similar to the process that resulted in no administration spokesman here today, and I submit that there would be great delay and not much action on this proposition of relief, because the administration is basically opposed to it.

If you want something accomplished, I think it has to be done in some way that directs action, with compromises with the administration, and it ought to be done in the form of explicit language rather than referring the problem to the Secretaries.

Thank you.

---

[1] See p. 87 for the prepared statement of Mr. Resler.

Senator HAYAKAWA. You want the language more explicit than it is?

Mr. RESLER. Yes. I submit that Senator Hatfield's original approach of attempting to try to find some consensus on a solution is preferable from the standpoint of legislation. He pointed out, as well, that that consensus was not fully achieved, and you have heard discussion around this table that suggests a difference in viewpoints.

But I think some form of relief is necessary, urgently needed; we have tried to explain that in our statement.

Senator HAYAKAWA. Thank you very much.

Now, you are Mr. Williams?

STATEMENT OF HARRY WILLIAMS, PRESIDENT, SOUTHERN FOREST PRODUCTS ASSOCIATION, ACCOMPANIED BY CLARK COSSE, COUNSEL

Mr. WILLIAMS. Yes, Mr. Chairman. I am Harry Williams, president of the Southern Forest Products Association, and chief executive officer of Williams Forest Products Corp.

You have a copy of my written statement.[1]

Senator HAYAKAWA. Yes, we do.

Mr. WILLIAMS. The Southern Forest Products Association represents about three-fourths of all the Southern pine lumber in America on a production basis.

The things that the South is predominantly interested in is, we are compassionate with the westerners, we would like to be part of the solution. I can honestly say that we want to help, but we don't want to get dislocated ourselves, and the only thing that is going to help is the marketplace, for interest rates to come down, home building to get back up in the area of 1.5 to 2 million. That is the only thing that is going to put everyone back to work.

Now, we have earlier this year, I think, made it clear that we could, and would, support contract term adjustments to give everybody time enough to get out. I don't think it would matter to us whether it is 3, 5, or 10 years. Let everybody have a chance to work out.

We would probably be able to go along with up to 40 percent termination if there is a cap put on the sales program in region 6, and by that I am saying that my good friend, John Crowell, has a very large sales program right now at a time when there is no demand in the marketplace, and what is happening is that the sales program far supersedes the cut, and we feel very strongly in the South that if the sales program is way above the cut of the mills in region 6, then it undervalues our raw material in the South, and since we get our timber from private lands, they don't respond like the Federal Government.

You see, the price of timber in region 6 right now is like 20 percent of what it was a year ago. There is no way that the private landowner in the South that we get our timber from is going to allow his timber to come down 80 percent in a 12-month period. It just doesn't happen.

---

[1] See p. 90 for the prepared statement of Mr. Williams.

Consequently, what happens to us, we are sitting there with our mills still operating pretty close to the level that we were a year ago, with stumpage, and when the big break, or the big crack came on the west coast, here comes their lumber.

Many of us own our own mills, and we own our lumber yards, and yet we go down to the lumber yards and find out managers are buying west coast lumber because they can buy it from the West $25, $30, or $40 a thousand cheaper than we can buy it from our own mill right there in town.

That is what happens to us when they have a sales program in the West that far exceeds what the cut is. The timber sells for just almost salvage price, and it undercuts the values of what our raw material is worth in the South, and that is literally what the Federal Government is doing.

They have sold so much more timber in the West than what the market would absorb that it has undercut the raw material value in the South, and we can't buy it for that.

So I think that is a very important consideration. I think we could support termination up to 40 percent, but we would have to have something in the legislation tying the sales program to the annual cut. Say, take the average of the last 5 years, so that there won't be such a deluge of sales in the West to depress the market, you know——

Senator HAYAKAWA. There is a huge discrepancy from region to region.

Mr. WILLIAMS. That is right. Homebuilding is now below 1 million, and everything was geared up to 2 million. How can you sell timber on a 2 million building level without displacing someone in another area, and that is exactly what has happened in our particular area.

So we would support contract term adjustments. We could support termination if there were a cap on region 6, or something to keep so much timber from being sold out there that it would undercut and displace us in the South.

We are absolutely against rollbacks. We think there is no way to have equity in rollbacks.

That is a pretty good summary, and I think that would be the consensus, by far, of the majority of our Southern delegation.

Thank you, Senator.

Senator HAYAKAWA. Thank you very, very much.

Mr. Hodges?

Mr. HODGES. I would defer to them.

Senator HAYAKAWA. Yes, sir.

STATEMENT OF PAUL F. EHINGER, EXECUTIVE VICE PRESIDENT, ACCOMPANIED BY RICHARD L. BARNES, COUNSEL, WESTERN RESOURCE ALLIANCE

Mr. EHINGER. I am Paul Ehinger, executive vice president, Western Resource Alliance,[1] a group of independent operators in the West primarily dependent on public timber. I have been listening to the conversation around the table, and in reference to Mr. Wil-

[1] See p. 94 for the prepared statement of Mr. Ehinger.

liams here, we have worked throughout the United States to get a nationwide consensus, realizing a lot of the tugs and pulls you have heard here are real.

Out of that, we have submitted to you a copy of legislation that was agreed to by all elements with the exception of the Southern people, who had a difference in figures on how we cap the Northwest region timber sale program, but in principle we were both agreed that we should not be dislocating other markets.

The legislation consists of about three main elements. One is 40 percent termination, which was arrived at by consensus among the industry as something that everybody could agree to, contract term adjustment for 5 additional years, and the making of purchaser credits for construction of permanent roads available on a uniform basis to all purchasers.

We had basic consensus throughout the country on this type of approach with the exception that we couldn't agree on the numbers for a cap on the Forest Service timber sale program with respect to region 6.

I would like to comment that we are looking at a group of people who, for whatever reason, have ended up with a series of contracts with the Federal Government which would, if forced to meet these contracts at any time in the present or reasonable future, would subject them to losses on an annualized basis exceeding the value of their assets.

In other words, an average contractor cutting 10 million feet a year would have at least $3.5 million as a loss if he were one of the average operators in the West, and that is probably the asset value of his mill. A lot of individual operators are in much worse shape.

It is not something that can be worked out with additional time alone.

We have charted out carefully with 40 percent termination, and 10 percent inflation in the log market, and assuming an operator could buy every bit of additional wood needed with a 10-percent profit, and working at a break-even point until 1988, the operator could possibly work out of the backlog of timber that was extended.

It is simply a problem beyond the scope of anybody to imagine how to get out of the dilemma without getting into legislation.

We discussed the flow of timber into the South. The WWPA report that was just quoted referred to a percentage, not a volume. The percentage shifted from approximately 14 percent to 17 percent of Western lumber going into the South, but that was at the expense of markets in the Northeast, primarily, and southern California, and those figures dealt with the whole Western region both coast and inland.

At the same time there was this minor shift, the Southern people had a 10-percent drop in production from last year for the first 5 months in this year. The West has had a 16-percent drop. So when we deal in percentages, yes, the percentages changed, but the volume went the other way. We have to be careful to deal in the right volume figures.

Mr. Thomas referred to the scale rule as a function of overrun in a sawmill. Overrun is also a function of the products that are made. If you make boards, you get one level of overrun. If you make timbers, you get another level, and if you make studs or di-

mension, you get still another. It also depends on how efficient your sawmill is.

I was involved in sawmills in the South that got 40 percent overrun, and in the West, only 10 percent. That was because of the product line. Scaling differs all over the world, and is not pertinent to this issue.

The current problem is bigger than we thought it was going to be, even as recent as a year ago, and it is only going to be solved with a legislative solution. We have a piece of legislation which has been submitted to you. The Western industry has a high degree of unity on it, and the South has considerable agreement, as Mr. Williams outlined earlier, and I would suggest that it be looked at as a substitute for some of the other legislation that has been put forward. It was endorsed by seven of the eight Western associations on July 14, 1982.

We agree with the inequity of the rollback, as Mr. Williams and other people have stated. We abandoned that a long time ago, because it was determined to be inequitable.

We cannot live with extension alone. The purchaser credit for building roads is an issue of equity. It is a matter of the Forest Service paying for the permanent roads that the Government gets as part of a timber sales contract.

Somebody said there is no equity. This is true when we look purchaser to purchaser or region to region. We can't go back to the beginning and start over again, but given this point in time equity must be viewed as finding the best solution to help the employees, the small businesses, the local governments and all the other people affected, out of the desperate circumstances in which we now find ourselves.

In doing that, this program evolved, and while it will not create more jobs except in roadbuilding, it will at least take the burden and liability off the backs of operators who are now fighting for their basic survival, and if nothing is done they are surely going to go off the face of the Earth and all the small communities dependent on these mills are going with them.

We will be hurting a lot of innocent people who were not at the bidding table, and had nothing to do with the change in monetary policy for financial and banking structure by the Government or the related policies. We need a solution.

I urge you to give this close attention, and hopefully the small areas of disagreement we have with our Southern friends can be resolved soon.

Senator HAYAKAWA. Where did you get the 40 percent figure?

Mr. EHINGER. It was reached as a negotiation between all the regions of the industry as a figure that could be accepted throughout the country.

Senator HAYAKAWA. I see. Let me interrupt at this point to introduce my distinguished colleague, Senator Pryor of Arkansas, who is a member of this committee. We were discussing the problems of the prices of lumber, the fact that because of the decline in the housing industry there are very great problems in the whole lumber industry, not only in the Northwest, as Senator Hatfield and I and others on the west coast understand, but we hear from many of our witnesses that there are great, great problems in the

98-286 O - 82 - 3

South as well, and in order to get everybody heard from in the shortest possible time, I have had them all gathered together around one table instead of having them as separate panelists, and each of them is giving a separate statement.

Do you have a statement you wish to make about this lumber business, Senator Pryor?

Senator PRYOR. Mr. Chairman, I deeply appreciate the opportunity to join you today, and I apologize for being so late.

Senator HAYAKAWA. Not at all.

STATEMENT OF HON. DAVID H. PRYOR, A U.S. SENATOR FROM ARKANSAS

Senator PRYOR. First, I would like to state that I hope my statement will in no way be interpreted as opposing the West, or not recognizing the very great problems that the Western timber industry is undergoing at this time.

Mr. Chairman and gentleman, I would also like to say that concern has been expressed to me by several members of our—or several parts of our—timber industry in the State of Arkansas, and I assume in the South, regarding this legislation.

There are some questions that I assume have been addressed this morning, such as the possibility of undercutting the prices in the South, and possibly flooding the market in the country and thus allowing prices to plummet even further.

I think, too, there is a question I would like to ask to any member of the panel, and that is, does this apply just to Western States? I think one of the questions at least raised and perhaps not asked by one of the people who testified from the Wilderness Society, or maybe from the Sierra Club, is one that I have been concerned with. If the contracts are terminated, then will we go into a new contract period where competition once again is allowed to work and replace the contracts that were terminated?

Mr. Chairman, I am sure a lot of these concerns have been raised and perhaps even answered, but if they have not then perhaps some of those questions could be assigned to various members of the panel for discussion.

Senator HAYAKAWA. Thank you, Senator Pryor. I want to tell you that we have had here representatives from the U.S. Department of Agriculture, U.S. Forest Service, we have had here representatives of forest products, the National Forest Products Association, a professor of applied economics, executive vice president of the American Forestry Association, we have had equally the lumber industry itself, people from the Western Resource Alliance, people from the Shuqualak Corp., the Potlach Corp.——

Mr. CHEEK. In Arkansas.

Senator HAYAKAWA [continuing]. People from the Shuqualak Lumber Co. I am so pleased I can pronounce it—and the Southern Forestry Products Association, and representation from the Wilderness Society and the Sierra Club. We have all kinds of groups represented here.

I shall continue, if it is all right with you, Senator Pryor, to invite other people to take part in the discussion.

Is Mr. John Hooper here yet?

Mr. KIRBY. Mr. Chairman, I spoke in his behalf at the outset.

Senator HAYAKAWA. He is not here?

Mr. KIRBY. No.

Senator HAYAKAWA. Senator Melcher, did you want to raise further questions? You were here at the beginning.

Senator MELCHER. Well, I want to be apprised if the industry believes some action is necessary on timber contracts. The legislation should be geared to the various sections of the country in such a way as to give us the broadest opportunity of survival of the most.

Mr. EHINGER. I might comment on that, since you were not here. We have introduced to the committee a copy of the draft legislation agreed to by most of the segments of the industry around the country, which tries to balance the needs. There are a few points of disagreement still, but in principle we have basic agreement, trying to serve the interests of the South, the East, and the West.

There are more people going to be affected in the Northwest than anywhere else. That is where the trouble is. It is like Willie Sutton said when asked the question "Why do you rob banks?" "Because that's where the money is."

The Northwest is where most of the problems are.

I would like to address the issue of bailout. People quantify what the loss to the Government will be, Mr. Sedjo repeated it, and other people have repeated it. The loss is stated as though it were some amount of money that the Government would be able to collect. I am telling you, gentlemen, it is simply something that is not going to be collected under any circumstances at anywhere above 10 cents on the dollar, because the magnitude of the deficit and the magnitude of the problems. Further assuming we have broken the back of inflation and we do not return to the 15-percent inflation of the 1970's again, there is no way that you are even going to come close to making those contracts workable in any real economic sense.

In other words, operators are not losing just $2, $3, or $4, per thousand board feet of timber or maybe $50,000 or $60,000 a month. The losses are staggering, in the millions, for individual operators, and it simply cannot be handled in terms of normal recovery measures. Contract damages will be fought in the courts, thereby by delaying a potential harvest, which probably will never come under existing contracts.

The resolution has to be done within a legislative approach, and in the process we have to try to balance out the needs of all regions so that we in the West do not transfer the problem to the South, or to any other region. It has got to be a carefully orchestrated process, and the figures we came up with for a 5-year contract adjustment and a 40 percent termination of contracts are tied together. They are not something that you can all of a sudden say, "We are going to do 100 percent on terminations and nothing on contract term adjustment," or vice versa.

They are both tied together as to the needs of the people in the various regions. They balance out a solution that possibly could be accomplished.

Senator HAYAKAWA. You are Mr. Ehinger, with Western Resource Alliance?

Mr. EHINGER. Yes.

Senator HAYAKAWA. Your paper includes the proposed legislation?

Mr. EHINGER. Yes.

Senator HAYAKAWA. Good. We will look at it with great care.

Mr. Barnes, do you have anything to add?

Mr. BARNES. Yes, Mr. Chairman. I think Senator Pryor and some of the Southern people touched on the question about the flooding of the market in the event of contract termination.

I think we have to look at the question of legislation not as legislation compared to what the ideal of the timber market was back in 1979, but versus what the situation will be if there is no legislation.

If there is no legislation and companies are forced to bankruptcies and wholesale terminations, or wholesale defaults of these contracts, then if the Government follows the normal default procedures and attempts to collect its damages it will have to reoffer these contracts onto the market very promptly.

Now, our proposal for termination is that the contracts be reoffered as a part of the regular sale program which would enable them to be metered in over time as the markets demand.

Where you will have the wholesale flooding of the market is if you have a lot of defaulted timber that comes on quite quickly.

Earlier this year the Forest Service in an attempt to curb what they viewed as some speculation from previous years in the markets, introduced somewhat stronger contract terms that require a greater level of financial participation by the purchaser earlier in the contract period.

If the Government offers defaulted contracts and attempts to recover its damages, it is going to have to offer them under the old contract conditions.

If it offers them as terminated resales, then it is able to use the conditions of contract which the Government now thinks to be better for the market and the industry as a whole.

So I think all in all that the regions most concerned about flooding will be worse off if there is no legislation than if there is legislation that we would hope responsibly recognizes the need not to flood the market and to reoffer sales as the market demands over time.

Senator HAYAKAWA. Thank you very much, Mr. Barnes.

There is one man here who described himself as a forester from whom we have not heard, Mr. Robert L. Davis. Do you have anything to add?

Mr. DAVIS. I would like to point out a couple of things to the committee.

Senator HAYAKAWA. Yes.

STATEMENT OF ROBERT L. DAVIS, FORESTER, SOUTHEASTERN LUMBER MANUFACTURERS ASSOCIATION

Mr. DAVIS. One is that I was in, observing and participated in many of the industry discussions on this matter, and the 40 percent bothered several members of the SLMA. The reason it bothered the members is, one, they thought it was high but, two, there were various ways of obtaining this 40 percent. Through changing dates of

when the volume would be figured, manipulating additional volume, 10 million board feet added on to the 40 percent, contracts up to 15 million board feet can be terminated, et cetera, et cetera. There were several ways to increase the percentage to be terminated.

I asked the question at one of the meetings that it seemed like all of this was a way to increase the 40 percent, and the answer I got was, yes, it was.

So we feel like we are not being told everything in this matter. So that is a problem.

The purchaser credit that we discussed is very important to the members of the SLMA. Firms that have multiforest operations, transferring purchaser credit between national forests will give them a greater cash flow advantage over firms that operate in only one national forest. For this reason the SLMA has in the past and will remain against any type of transfer of purchaser credit between national forests. We can't be for that in any form.

I will rest with that.

Senator HAYAKAWA. Yes?

Mr. HANKE. Mr. Chairman, it seems to me, if I could characterise the Southern objection, or concern, they would prefer to have the Forest Service and Mr. Crowell act like an Arab sheik in an OPEC-type of arrangement that would constrain the supply and maintain high prices and current market shares.

One way that we might be able to get out of this box is to implement a proposal that I developed when I was at the President's Council of Economic Advisers. The U.S. should drop the export ban on logs from Federal lands so that they could be sold overseas. Then these logs wouldn't be flooding the U.S. markets. We could have a tie-in arrangement whereby we sold these high-priced contracts to the Japanese and others in Southeast Asia, and we tied those high-priced sales into the sale to the Japanese of lower priced logs, maybe 10,000 or 20,000 board feet over a 10-year period on down the line. This would give the Japanese the log security they desire.

This plan would certainly be one way to get out of the apparent conflict between the Southern region and the Pacific Northwest. If we got rid of the export ban on logs and simply made some sales arrangement with the Pacific rim demanders, it would benefit the Pacific Northwest, without hurting the South. They are shipping logs off private lands in the Pacific Northwest to the Japanese and others in the Pacific rim right now at fairly reasonable prices, significantly higher than spot prices in the United States. So this is something you should consider to get the industry back on its feet.

SENATOR HAYAKAWA. All right.

Mr. EHINGER. Could I respond to that quickly? The export market is depressed. It is taking all it can absorb, and most of these current timber contracts are outside the price of log exports.

SENATOR HAYAKAWA. You are saying that the Japanese don't want more than they are getting now?

Mr. EHINGER. That is right. They are getting more than they want.

Mr. THOMAS. May I ask a question of you, Paul?

Paul, one thing I have never understood that if you could briefly explain to me, I would appreciate it. Every time I ask the question, it is said, It can't be done. Why could not these high-priced contracts, given enough time, whatever it be, mixed in with these low-priced sales now, be worked out over the years, given enough time—20 years?

Mr. EHINGER. The problem you get into is that those sales block other sales. Some sales are salvage sales or deteriorating timber, and if you give them to the time the market comes back, the timber won't be there.

Mr. THOMAS. Salvage sales are high-priced sales?

Mr. EHINGER. Yes. There are a lot of those out there that need to be dealt with.

Mr. THOMAS. Given enough time, could this not be worked in?

Mr. EHINGER. Right now the average log goes for $200. The delivered price on many contracts is $600 or higher. If we are ever going to reach that level of marketability, all right. But most of us are of the opinion that with the change in the housing market and the reduction in inflation rates, we will never see that high price again in this century.

Mr. THOMAS. You might be right.

Senator HAYAKAWA. Mr. Hodges has asked to be the last speaker, but Mr. Cosse has not spoken at all yet.

Mr. COSSE. I want to respond to Senator Pryor, who asked whether or not this pending legislation would have an effect on the South and the Southern national forests.

Senator HAYAKAWA. Will you use the microphone, please? Mr. Cosse. The differential between 1978 prices in the South in Federal forests and today is only $5 a thousand on the average. So any reduction or termination would only help those people who held this very small amount of timber.

But the real problem comes in if there is 40 percent, or in if there is a contract term adjustment. We have to have some mechanism by which we can keep too much timber from coming on the market out West. In our earlier presentation, we pointed out that more and more of this Western timber has been lower in cost than Southern-produced timber in the very vicinity of the sales.

They can transport it from Oregon all the way to the South and still be lower in price. We are very much concerned with that. We are supportive and want to help the industry out West, but we have got to maintain our markets at home, if we are to survive.

Senator PRYOR. That is a blunt question, but what are we going to do for the South?

Senator HAYAKAWA. Let them secede. [Laughter.]

Senator PRYOR. We tried that one time. We attempted that, and it fell through.

Mr. DAVIS. Senator, the only thing that I see the South would get out of this accommodation is contract term adjustment which could help some small percentage of our people who have some high prices for Forest Service timber. It would give them time to work out this timber and blend it in and not take a real shellacking. Understand that the Forest Service timber in the South is such a small part of our overall volume that we are not going to get a lot of benefit from legislation. One thing that does bother me, if we

are a part of the solution, and they do have mass default, and the Northwest continues with their sale program as it is now structured, when they put that timber right back on the market, this will put a oversupply of lumber on the market when we still have got a million or less housing starts.

The Northwest is putting timber on the market to support 2 million housing starts, which is almost twice as much timber as needed. It is said that realistically there is at least 25 percent more timber in region 6 being sold than should be sold as far as what the market would call for on a demand basis.

OK. If they have massive defaults and they put this additional timber back on the market in addition to what they already have, they are going to undervalue lumber to the point that I don't know how the South could survive.

Now, somehow or other we have got to be—well, we want to be sympathetic and accommodating, but we are not going to get overrun, if we can possibly help it.

Mr. EHINGER. I make one comment from the Western position. If we are ever to average out the remaining 60 percent, we cannot afford to create the low-priced markets like Mr. Williams has described, and so, as I said, we have a common interest here. We just have a disagreement of how we get there at the moment.

Senator HAYAKAWA. A brief comment, Mr. Cheek.

Mr. CHEEK. Mr. Ehinger several times referred to the Western position and the consensus. We are in the West, and I don't believe a consensus exists on the terms he is talking about. We have come to a consensus, I think, that a solution must be found in the elements in the legislation that has been proposed, but we are one very long way from deciding just how those elements should be applied.

There is no industry consensus on a final solution.

Senator MELCHER. Mr. Chairman?

Senator HAYAKAWA. Senator?

Senator MELCHER. I need to have two indications. One is, how many of you are opposed to timber purchase credits? Signify by raising your hands.

Mr. THOMAS. To transfer? I am opposed.

[Show of hands.]

Senator MELCHER. I just wanted to know how many did not want it in the bill.

Mr. THOMAS. You can't answer that, sir, by what you said.

Senator MELCHER. Well, then, can I have from each group an answer, a brief an answer as possible, on whether that would be good, or bad?

Mr. DAVIS. To transfer credit within a forest, we would support that, but if you start transferring it from one region to another, no, this we can't support. But if you stay within the same region, we can support that.

Senator MELCHER. All right.

If you want to elaborate, I would be glad to have a written comment. I believe Senator Hayawaka would, too.

The other part of the question is, How many of you approve some action by Congress to expedite the proceedings before the International Trade Commission on the Canadian subsidy?

[Show of hands.]

Senator MELCHER. Do most of you? You are shaking your heads. I guess so. Are any of you opposed? [No response.]

Senator HAYAKAWA. We have a complete transcript, Senator, of the discussion of this group over the past hour and 10 minutes. We will have that before us. I have promised this group that we will break up at 12 noon, but before we do, we will have a final statement from Ralph Hodges, who is executive vice president of the National Forest Products Association.[1] After that, we will adjourn.

STATEMENT OF RALPH D. HODGES, EXECUTIVE VICE PRESIDENT, NATIONAL FOREST PRODUCTS ASSOCIATION, ACCOMPANIED BY JOHN HALL, VICE PRESIDENT, RESOURCES

Mr. HODGES. First I just wanted to applaud you, Mr. Chairman, for the statement you made when Senator Hatfield was here, that you wanted to expedite progress on this issue. Second, you can see a vast number of concerns that were expressed by the witnesses. I would hope that the committee would give particular attention to what would happen if there is no legislative solution, that is, if the solution is simply one of default.

In that case, I would submit that most of the concerns expressed around the table would be worsened by no action.

Senator PRYOR. Mr. Chairman, I know you have made a commitment, and I am going to try to meet that.

Senator HAYAKAWA. Please do, Senator Pryor.

Senator PRYOR. Once again, I want to reiterate that I come here to try to find a solution, and not to be an obstructionist.

I was thinking of other meetings where you and I and Senator Melcher come every week to this room, to this very same table, to the Senate Committee on Agriculture, to deal with the same problem that we deal with today.

That is, how to deal with America's richness and overabundance in natural resources. What do we do with our rice, which we have in quantities that we cannot even sell for half of the price of production, and our corn and wheat, and other products. How do we divide up the richness of this country into a system and mechanism where we achieve equity and fairness? It is a very delicate balance. One of the deep concerns we have had in this committee is how do we do this without involving the Federal Government in the free enterprise system, in the system of production which we all admire and which is certainly the most productive in the world. How do we do that in a manner that strikes a balance, and what precedents do we establish? I think this is one of those areas that gives me a great deal of concern, especially in regard to termination.

We have a matter over on the Senate floor just this afternoon, and I am not trying to lobby about it, and I don't know how I will vote on it, guaranteeing job security for airline employees in case of mergers. That, once again, I think, is a precedent which this Congress should look at, and I think this may be a precedent that we certainly have to look at.

---

[1] See p. 123 for the prepared statement of Mr. Hodges.

I stand willing and able as one individual Senator to work with our friends and our colleagues in the West, in hopefully trying to find some balance and answer to the real dilemma that we have.

The best way out of it, of course, is for us in Congress to find a way of lowering interest rates. That would solve the problem here today, and solve the problem of the farmer and industry, and many more. I just wanted to make those points.

Senator HAYAKAWA. Thank you very much, Senator Pryor.

One of the great pleasures of working on this committee is that it is nonpartisan. We do work together on common problems, not as Republicans versus Democrats, or Democrats versus Republicans, but because we have a surplus of this and the price of this is too high, or the price of that is too low. We work together to increase our exports, to get a better price for this or that commodity, and it is a pleasure to work with this committee.

As I say, we have less partisanship here than any other committee that I know of.

I want to express my deep gratitude to all of you for the trouble you have taken to come here to express your opinions, to enrich our insights into the problems we have before us.

Senator Hatfield, Senator Melcher, and Senator Pryor and the House Members will be working on it. We will hold another hearing if necessary. We will keep working at it and try to get something done as expeditiously as possible, as satisfactory to as many people as possible.

The statement of Senator Huddleston will go into the record.[1]

The hearing is adjourned.

[Whereupon, at 12:10 p.m., the subcommittee adjourned, subject to the call of the Chair.]

---

[1] See p. 39 for the prepared statement of Senator Huddleston.

APPENDIX

STATEMENT OF HON. WALTER D. HUDDLESTON, A U.S. SENATOR FROM KENTUCKY

Mr. Chairman, the Nation's timber industry is suffering severe economic hardship as a result of the current economic slump and high interest rates that have depressed the housing market.

Presently, many timber companies are holding high-priced purchase contracts for timber located on Federal land that cannot be profitably harvested at today's depressed prices. In an effort to help prevent serious economic disruption to communities and industries dependent on national forest timber, the Forest Service has made administrative changes in the way sales are handled and payments collected.

However, because the recession has persisted and become more severe, Congress will now consider measures that would provide further relief for the timber industry. Such proposals deserve serious consideration.

In considering these proposals, we must balance the Nation's need for a viable and competitive timber industry, able to meet the demands of a healthy economy in the future, against the need to insure that contracts be honored and that the contract process designed to minimize speculation and protect the public interest be protected.

These hearings will provide us with the information needed to decide this important matter.

STATEMENT OF HON. MARK O. HATFIELD, A U.S. SENATOR FROM OREGON

THANK YOU MR. CHAIRMAN FOR THE OPPORTUNITY TO APPEAR THIS MORNING AND DISCUSS A SERIOUS PROBLEM THAT CONFRONTS THE WESTERN TIMBER INDUSTRY. I HAVE INTRODUCED S. 2805 TO ALLEVIATE THE ACUTE ECONOMIC STRESS OF THE FOREST PRODUCTS INDUSTRY, AN INDUSTRY WHICH IS ESSENTIAL IN MEETING OUR NATION'S HOUSING NEEDS. THE LUMBER AND WOOD PRODUCTS INDUSTRY IS THE BACKBONE OF THE OREGON ECONOMY AND OTHER TIMBER PRODUCING STATES IN THE WEST. I HAVE INTRODUCED THIS LEGISLATION BECAUSE I BELIEVE THAT MANY SMALL, INDEPENDENT COMPANIES ARE ON THE VERGE OF BANKRUPTCY AND BECAUSE THE FEDERAL GOVERNMENT IS INVOLVED IN THE SITUATION ALREADY. IN MY STATE, 73 LUMBER MILLS ARE CLOSED. IN WASHINGTON AND CALIFORNIA, THE NUMBER OF MILLS CLOSED IS 59 AND 40, RESPECTIVELY. LET ME EMPHASIZE THAT I AM NOT ASKING THE FEDERAL GOVERNMENT TO SPEND ONE NICKEL TO AID THIS DISTRESSED INDUSTRY. RATHER, I AM PROPOSING THAT THE FEDERAL GOVERNMENT, WHICH IS THE MAJOR SELLER OF TIMBER IN THE WEST, BE EMPOWERED TO MODIFY OR TERMINATE ITS CURRENT TIMBER SALES CONTRACTS WITH THEM. FAILURE TO ACT WILL WREAK HAVOC UPON THOSE EMPLOYED IN THE INDUSTRY, LOCAL COMMUNITIES WHO RELY ON TIMBER SALES REVENUES, AND THE FEDERAL TIMBER SALES PROGRAM. THE CURRENT RECESSION HAS IMPACTED INDUSTRIES THROUGHOUT THE NATION AND, AS IN PREVIOUS RECESSIONS, THE HOMEBUILDING INDUSTRY HAS BEEN PARTICULARLY HARD HIT. SOME

OF MY COLLEAGUES MAY ASK, "WHY SHOULD ACTION BE TAKEN TO AID ONE AILING INDUSTRY? WHY NOT PUT OUR EFFORTS SOLELY INTO AN OVERALL ECONOMIC RECOVERY WHICH WILL BRING ABOUT HOMEBUILDING?"

MY ANSWER IS THAT I AGREE THAT WE MUST CONTINUE TO WORK TOWARD OVERALL ECONOMIC RECOVERY. BUT, WITHOUT ACTION SOON TO DEAL WITH THIS SITUATION, THAT INDUSTRY WHICH MUST PROVIDE THE BUILDING MATERIALS NECESSARY TO HOUSE OUR PEOPLE WILL CONTINUE TO BE DECIMATED BY DEPRESSION, AND ITS STRUCTURE WILL BE SEVERELY AND ADVERSELY ALTERED BY THE TIME ANY SUBSTANTIAL RECOVERY OCCURS.

SINCE OCTOBER 1, 1979, TEN WOOD PRODUCTS FIRMS IN OREGON HAVE TAKEN BANKRUPTCY. SIX OTHER COMPANIES THAT ARE INVOLVED IN REMODELING AND RELATED HOMEBUILDING ACTIVITIES HAVE ALSO GONE BANKRUPT. ALTHOUGH FIGURES ARE NOT AVAILABLE, IT CAN BE SAFELY STATED THAT MANY OTHER COMPANIES THAT HAVE DIRECT TIES TO THE WOOD PRODUCTS INDUSTRY HAVE ALSO GONE BANKRUPT. TODAY, MANY OTHER FIRMS IN THE INDEPENDENT SEGMENT OF THE LUMBER AND WOOD PRODUCTS INDUSTRY ARE FACING BANKRUPTCY. IN THE WEST, THESE COMPANIES ARE ALMOST TOTALLY RELIANT ON GOVERNMENT TIMBER FOR THEIR RAW MATERIAL. TIMBER IS PURCHASED UNDER CONTRACTS DICTATED BY THE GOVERNMENT WHICH IN MANY INSTANCES ENJOYS A MONOPOLY POSITION AS THEIR SUPPLIER. TYPICALLY, THESE FOREST PRODUCTS COMPANIES PURCHASE GOVERNMENT TIMBER ON A SCHEDULE THAT PROVIDES

THEM WITH A TIMBER SUPPLY FOR SEVERAL YEARS, SO THAT THEY MAY PLAN PROPERLY.

DURING THE 1970'S, HOMEBUILDING DEMAND WAS HIGH AND TIMBER SHORTAGES WERE PROJECTED. MANY COMPANIES INVESTED SUBSTANTIAL SUMS OF MONEY IN MILL IMPROVEMENTS TO ALLOW GREATER UTILIZATION OF TIMBER. THIS INCREASED THE NECESSITY TO HAVE A STABLE SUPPLY OF TIMBER UNDER CONTRACT, AND COMPANIES BID THE HIGHEST PRICES POSSIBLE FOR GOVERNMENT TIMBER BASED UPON THEIR PROJECTIONS OF LUMBER AND PLYWOOD PRICES WHEN THE LOGS WOULD BE MILLED, USUALLY AT LEAST TWO YEARS IN THE FUTURE. FEDERAL TIMBER CONTRACTS HAVE HAD LITTLE IN THE WAY OF FINANCIAL REQUIREMENTS ON THE PART OF THE PURCHASER AND, DURING THE 1970'S THIS SYSTEM WORKED; IN FACT, IT WORKED PARTICULARLY WELL FOR THE FEDERAL TREASURY. IN 1979, NATIONAL FOREST TIMBER RECEIPTS TO THE TREASURY TOTALED 854.7 MILLION DOLLARS. IN 1980, THE RECEIPTS TOTALED 614.6 MILLION DOLLARS, AND IN 1981, RECEIPTS TOTALED 596 MILLION DOLLARS. ALTHOUGH FIGURES FOR 1982 ARE NOT AVAILABLE, THE FOREST SERVICE ESTIMATES THAT RECEIPTS WILL BE DOWN SUBSTANTIALLY. DURING THIS DECADE WE HAD FEDERAL HOUSING POLICIES WHICH FOSTERED HOMEBUILDING. THE ENTIRE PICTURE HAS NOW CHANGED. WITH THE SHIFT IN THE FEDERAL ECONOMIC PROGRAM AND THROUGH A COMBINATION OF TIGHT MONEY, HIGH INTEREST RATES AND DEREGULATION OF FINANCIAL INSTITUTIONS, CAPITAL HAS BEEN CHANNELLED AWAY FROM HOUSING.

HOUSING STARTS HAVE PLUMMETTED FROM THE MORE THAN TWO MILLION ANNUALLY WHICH CHARACTERIZED THE 1970'S TO LESS THAN ONE MILLION.

THIS SITUATION HAS PUT THE COMPANIES WHO BID COMPETITIVELY FOR GOVERNMENT TIMBER IN A TERRIBLE BIND. THE PRICES OF THE LUMBER AND PLYWOOD THEY PRODUCE ARE MUCH LOWER THAN THE PRICES OF GOVERNMENT TIMBER THEY HAVE UNDER CONTRACT. IN OREGON AND WASHINGTON, FOR EXAMPLE, THERE IS ABOUT TWENTY BILLION BOARD FEET OF GOVERNMENT TIMBER UNDER CONTRACT. AS MUCH AS 75% OF THE VOLUME UNDER CONTRACT BID AS OF JANUARY 1, 1982 CANNOT BE ECONOMICALLY HAVESTED, RESULTING IN A POTENTIAL DEFAULT SITUATION OF DRASTIC PROPORTIONS. SOME OF THE VERY LARGE COMPANIES, WHICH ALSO OPERATE PULP AND PAPER PLANTS AND HAVE EXTENSIVE TIMBER LAND HOLDINGS WOULD NO DOUBT SURVIVE, BUT MOST OF THE SMALL AND MEDIUM SIZED COMPANIES WOULD BE FORCED TO CLOSE DOWN AND DEFAULT ON THEIR CONTRACTS. MASSIVE DEFAULTS WOULD CREATE CHAOS FOR THE COMPANIES, THE FEDERAL AGENCIES WHICH ADMINISTER THE CONTRACTS, THE COUNTIES WHICH SHARE IN THE TIMBER SALE RECEIPTS, AND THOSE WHO WORK IN THE MILLS AND IN OUR FORESTS.

THIS PROBLEM THREATENS THE INDUSTRY WHICH IS THE PREDOMINANT SOURCE OF ECONOMIC ACTIVITY AND IS THE LARGEST SINGLE EMPLOYER IN THE PACIFIC NORTHWEST. PRIOR TO ITS COLLAPSE, THE LUMBER AND WOOD PRODUCTS INDUSTRY PROVIDED OVER A QUARTER OF ALL REGIONAL MANUFACTURING JOBS. IN OREGON, ABOUT ONE THIRD OF ALL

MANUFACTURING JOBS HAVE BEEN IN THE LUMBER AND WOOD PRODUCTS INDUSTRY. WHEN THE JOBS INDIRECTLY DEPENDENT UPON THE INDUSTRY ARE TAKEN INTO ACCOUNT, THE LIVELIHOOD OF HALF OF OREGON'S POPULATION IS AT STAKE IN THE HEALTH OF THIS INDUSTRY.

NEARLY 40 PERCENT OF THE NATION'S LUMBER PRODUCTION AND OVER HALF OF ITS PLYWOOD PRODUCTION HAS COME FROM THE PACIFIC NORTHWEST. THE DEMISE OF THIS INDUSTRY WOULD HAVE ENORMOUS IMPACTS UPON THE NATION'S BALANCE OF PAYMENTS.

SINCE 1979, 22,000 OF THE 90,000 DIRECT JOBS IN OREGON' PRODUCTS INDUSTRY HAVE BEEN LOST. HALF OF THE MILLS IN MY STATE HAVE SHUT DOWN OR CURTAILED OPERATIONS. MANY OF THOSE MILLS STILL OPERATING ARE OWNED AND OPERATED BY PEOPLE WHO LIVE IN COMMUNITIES NEARLY COMPLETELY DEPENDENT ON THE PAYROLLS OF THE MILLS THAT OPERATE THERE. BUT THE OUTLOOK FOR THEIR CONTINUED OPERATION IS, IN MANY CASES, VERY POOR.

WHEN TWO PARTIES ARE INVOLVED IN A CONTRACTUAL AGREEMENT, AND DRASTICALLY CHANGED CONDITIONS DISABLE ONE OF THOSE PARTIES TO THE POINT WHEREBY THE CONTRACT CANNOT BE FULFILLED, THERE ARE TWO OPTIONS: DEFAULTING ON OR MODIFICATION OF THE CONTRACT. THAT IS PRECISELY THE CHOICE WE FACE TODAY.

THE STATES OF OREGON, WASHINGTON AND CALIFORNIA, ALL OF WHICH SELL TIMBER FROM THEIR LANDS, HAVE FACED THIS ISSUE DIRECTLY WITH

RESPECT TO THEIR OWN FORESTS. EACH OF THESE STATES ENACTED LEGISLATION TO MODIFY EXISTING TIMBER SALES CONTRACTS. OREGON AUTHORIZED MODIFICATION OF PRICES AND EXTENSIONS OF ITS CONTRACTS. WASHINGTON AUTHORIZED TERMINATION WITHOUT PENALTY OF A PORTION OF ITS CONTRACTS AND EXTENSIONS. CALIFORNIA AUTHORIZED MODIFICATION OF CONTRACT PRICES. THE LEGISLATION I HAVE INTRODUCED PROVIDES SIMILAR AUTHORITY TO THE FEDERAL TIMBER SELLING AGENCIES.

INTRODUCTION OF THIS LEGISLATION FOLLOWS MONTHS OF DISCUSSION AND DEBATE AMONG THOSE WHO ARE INVOLVED IN AND AFFECTED BY THE FOREST PRODUCTS INDUSTRY. LAST DECEMBER, I PROPOSED THAT THE DEPARTMENT OF THE INTERIOR MODIFY ITS CONTRACTS SO THAT PRICES WOULD REFLECT CURRENT VALUES. IN THE ENSUING EIGHT MONTHS, MANY MEMBERS OF THE INDUSTRY HAVE WORKED DILIGENTLY TO DEVELOP A PROPOSAL WHICH REPRESENTS THEIR NATIONAL VIEWPOINT ON THIS MATTER. MANY SUGGESTED RELIEF OPTIONS WERE PRESENTED, AND A PACKAGE OF PARTIAL TERMINATIONS, CONTRACT EXTENSIONS, AND A PROPOSAL MAKING "INEFFECTIVE PURCHASER CREDITS" EFFECTIVE SEEMED TO HAVE THE SUPPORT OF A GOOD SEGMENT OF THE WOOD PRODUCTS INDUSTRY. WHILE THE LEGISLATION I HAVE INTRODUCED ENCOMPASSES SOME OF THESE POLICY CHANGES, IT IS NOT THE PROPOSAL OF INDUSTRY. MY BILL IS MUCH BROADER IN SCOPE. IT GIVES THE SECRETARIES' OF AGRICULTURE AND INTERIOR THE TOOLS NECESSARY TO DEAL WITH THE PROBLEMS I HAVE

98-286 O - 82 - 4

OUTLINED THROUGH CONTRACT MODIFICATION OF TERMINATION, BUT IT DOES NOT SET OUT THE SPECIFIC METHODS OF IMPLEMENTING THEM. IT IS MY BELIEF THAT, BECAUSE OF THE INTRACACIES OF THE PROBLEM, HEARINGS ARE NECESSARY TO BEGIN TO DEVELOP THE TYPE OF RELIEF PACKAGE THAT IS NEEDED. IT IS MY HOPE AND BELIEF THAT THIS COMMITTEE, ALONG WITH THE ENERGY AND NATURAL RESOURCES COMMITTEE, CAN AND WILL DEVELOP THE FINAL PRODUCT THAT CAN BE TAKEN, WITH A UNIFIED VOICE, TO THE SENATE FLOOR.

MR. CHAIRMAN, THAT CONCLUDES MY FORMAL REMARKS. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS THAT SUBCOMMITTEE MEMBERS MIGHT HAVE.

STATEMENT OF
JOHN B. CROWELL, JR.
ASSISTANT SECRETARY FOR NATURAL RESOURCES AND ENVIRONMENT
UNITED STATES DEPARTMENT OF AGRICULTURE

Thank you for providing us the opportunity to join the Subcommittee's deliberations on legislation to grant relief to purchasers of National Forest System and public lands timber. The adverse economic situation that a segment of the forest products industry is in today and the intimate role the Federal Government plays in its cause and its potential cure is indeed a complex subject and one that will require our very best efforts. We assure you of our complete cooperation in your deliberations.

I would like to begin my statement with a brief overview of the circumstances which led to the introduction of S. 2805 and S. 2818.

About 25 percent of the timber used to manufacture lumber and plywood consumed in the United States is harvested from Federal lands, nearly all of which is managed by the Forest Service and Bureau of Land Management. These two agencies contract with timber purchasers to harvest timber which has been designated specifically on the ground and on which an appraisal has been made. There is considerable competition for these contracts which are sold by oral auction or sealed bid. Contract lengths commonly range from 1 to 5 years, with an average of about 2 1/2 years. Normally, payment is made before timber is removed from the sale area. The largest volumes of Federal timber are sold in the Far West. Sales in the Pacific Northwest States and northern California comprise over 60 percent of the average volume of total Federal timber sold annually. Over 80 percent of Federal timber purchases are made by small businesses. These firms purchase over half the volume of Federal timber.

The severe slump in homebuilding since 1979, because of continued high interest rates for long term borrowings, has significantly reduced demand for and the prices of lumber and plywood. This in turn has had a direct impact on existing Federal timber sale contracts, creating a situation in which many of these sales cannot be economically operated. The Forest Service has estimated that 88 percent of National Forest timber volume under contract in western Oregon and Washington is at prices above the average purchaser's current break-even point, where the cost of production exceeds product selling value. Additionally,

it is estimated that 6 of the 22 billion board feet currently under contract in the three Pacific Coast States could not be operated at even the highest prices the market has ever seen. It is important to recognize also that many mills in this region own little or no forest lands and are heavily dependent upon Federal timber as their source of raw material. This dependency has increased over the past two decades as privately owned mature timber available for purchase has been harvested.

The expectation of the forest products industry, and particularly of those mill operators who owned little or no timber was that, as timber from private sources became scarce, increasing volumes would be made available from the accumulated large inventories of old growth timber on western Federal forest lands, particularly on the Pacific Coast. In fact, Federal timber sales did gradually increase from 1950 until 1969, but have remained virtually at the same level for the last 13 years. This occurred despite the fact that half the standing softwood sawtimber inventory in the United States today is on the National Forests where the inventory approximates one trillion board feet. The timbered portion of the National Forests and their natural growth rates could support a considerable increase in harvest rates. Sale programs in the last decade have averaged only between 10 and 11 billion board feet annually while industry sources argue that a substantially higher level should be sold annually.

Thus, because the Federal Government did not sell timber in volumes sufficient to support existing mill capacity, and there was insufficient volumes of private timber in certain areas, excessive bidding by mill owners occurred with each trying to acquire an adequate supply of raw material. The competition for limited timber offerings has been fierce. The operator with timber under contract at least had a hope of protecting his investment, whereas the one without timber was forced to close his operation and to liquidate his mill facility.

Another cause of the present situation, has been the unremitting inflation of the last 18 years. Timber prices, because of the constraints on supply, moved up even faster than the wholesale price index. The inflationary increases in timber prices, plus the obvious demand for new housing as a consequence of population growth and new family formations, played a significant part in causing escalated prices to be bid for available Federal timber.

Still another factor contributing to high bid prices was the uncertainty caused by controversy over designation of additional National Forest System lands as wilderness. Such designations reduced the level of Federal timber harvest, and controversy over management of other roadless areas created concerns by purchasers about future timber supplies.

The continuing low demand for wood products and the housing slump has resulted in a sharp drop in prices bid for Federal timber. During the first quarter of 1980, the average bid price for Douglas-fir stumpage on National Forests in western Oregon and Washington was $486 per thousand board feet. During the first quarter of 1982, this price had dropped to $153 per thousand board feet.

Many West Coast producers have been priced out of the market because they hold contracts on high-priced timber. As demand for wood products has declined, they have been forced from the market place, leaving the reduced demand to be met by those producers who have lower operating costs. In fact, some of the West Coast producers do hold some lower priced timber, so they can continue to operate on a curtailed basis utilizing only that timber. The same economic law, of course, has operated identically on all other producers for the North American lumber and plywood markets, forcing the least efficient ones in every region of the United States and Canada to curtail production or to shut down completely.

Because so much Federal timber under contract at high prices is in the Pacific Coast States, the consequences of being an inefficient producer because of high timber prices have tended to center there. Mills have ceased or curtailed operations, their employees have been out of work, dependent communities have suffered, and timber sale receipts to the Federal Treasury and to the local counties have declined. Mill owners have sustained operating losses and have suffered impairment of their capital; they are short of cash, and probably have had trouble repaying loans or getting new ones. Some of the high-priced timber sales will not be operated during the original or extended contract term and will default. The defaulting purchaser will then be liable for damages to the United States, which he may not be able to pay promptly, or ever. The amount of damages is ordinarily determined by reselling the timber, with the original purchaser becoming liable for the difference between the contract value

at the expiration date of the original contract and the resale value, plus costs of the resale. Under current policies the defaulting purchaser is prohibited from bidding on the resale.

The Federal timber selling agencies have been acutely aware of the problems experienced by holders of high-priced contracts and have taken a number of steps in the last two years to help alleviate them. Both agencies have granted extensions of termination dates for the contracts. The Forest Service has implemented two such extensions, the first for one year with fairly stringent conditions, the second for two years on condition that interest payments be made on the price for the unharvested timber. The Bureau of Land Management has extended its contracts to December 31, 1983. Both agencies could grant further extensions.

On April 15, 1982, Forest Service timber sale procedures were changed with the objective of discouraging future purchasers from buying and holding large volumes of timber under contract. The Forest Service now requires an advance cash deposit to be made by the successful bidder within 30 days of sale award. The amount of the performance bond has been increased. A system of discounting bid prices to encourage early performance of the contract has been established. And, the purchaser is now required to make a midpoint payment on the contract. Keep in mind that these changes in the way the Forest Service sells timber apply to sales made since April; they are not retroactive. The BLM also is changing its procedures to require up front payment of 5 percent of purchase price up to a maximum of $25,000. They also will require payment of at least 40 percent of purchase price by the end of the second year on a three year contract. They will prohibit purchasers who have defaulted from bidding on new sales until arrangements for payment of damages on defaulted sales are made. Also, it will require that the maximum required as installment payments be $50,000 instead of $10,000.

Also, the National Forests and BLM in Oregon and Washington rearranged their timber sale program for fiscal year 1982 so as to sell contracts of short term and smaller volumes early this year. This was done to provide operators with an opportunity to acquire volumes at prices which they could operate in the current depressed market for wood products. The desired effect was achieved. Stumpage prices came down substantially, thereby enabling buyers to reduce

their overall costs, and providing opportunity for them to return to the market place with at least some manufactured products.

It is imperative that the regular timber sale programs of the Forest Service and the BLM be carried on without curtailment during these difficult economic times. Some portion of the volumes sold can be harvested promptly, thereby keeping mills operating at least part time as the market for lumber and plywood allows. It is also important to assure future timber supplies on a regular basis and in needed quantities to meet increased market demands in the future so that stumpage prices can be maintained at reasonable levels. Availability of lower priced volumes also will permit averaging such volumes against the older, high-priced sales so that the latter volumes can be processed.

The legislative proposals in S. 2805 would authorize the Secretaries of Agriculture and the Interior to reduce prices, to terminate, or to extend certain existing timber sale contracts. S. 2818 would only authorize the Secretaries to adjust termination dates of timber sale contracts in effect prior to January 1, 1982, for a period equal to the original term but not to exceed five years.

Each of these authorizations has advantages and disadvantages, each would be impossible to administer with even-handed fairness, but all would grant a greater or lesser measure of relief to holders of high-priced contracts. Each of the authorizations is opposed by one or another groupings within the forest products industry, unless the authorization is carefully limited in very detailed specifics.

The Administration strongly opposes any rollback of prices on high-priced contracts. Rollback is grossly inequitable; it allows those who purchased the timber at high prices subsequently to enjoy the advantages of holding it without having to pay the agreed price, while those who would not bid the excessive prices have, in many instances, suffered the consequences of not having an adequate timber supply. Further, the objectives of providing employment and receipts to the Treasury and to the counties can be accomplished by continuing the regular sales program so as to get timber into the market at currently operable prices.

Although contract terminations without penalty do make the high-priced timber available again to all prospective purchasers and would permit early operation of the resold timber to occur, terminations totally relieve the original purchaser of his contractual obligations, all at the expense of the United States. In a free market system where mistakes are supposed to be paid for by the person entering into the contract, that form of relief is extremely generous. Therefore, the Administration also opposes the provision in S. 2805 which would authorize contract terminations without penalty. We must make it clear, in fact, that the Administration opposes any legislative remedy which would provide broad general relief, as would S. 2805, to one sector of the economy which is not available to other troubled sectors.

Since S. 2805 and S. 2818 address extensions and adjustments of termination dates, two definitions are appropriate at this point. A "contract term adjustment" under Forest Service timber sale contracts simply extends the termination date of the contract. It is the device BLM has used to lengthen all of its contracts to December 31, 1983. An "extension," as used in Forest Service contracts, requires a reappraisal, possibly leading to a higher contract price, and the imposition of additional obligations.

Forest Service contracts contain carefully drawn provisions prescribing the conditions under which "contract term adjustments" and "extensions" will be available. "Contract term adjustments" are available only as a consequence of force majeure occurrences, not including depressed market conditions. Thus, "extensions" have been the device used to lengthen Forest Service contracts. The Forest Service is constrained from converting "extensions" to "contract term adjustments" both by the provisions of its contracts and by the principle that it cannot modify an existing contract to the detriment of the Government.

Both S. 2805 and S. 2818 would apparently authorize use of contract term adjustments to extend BLM and Forest Service timber sale contracts. The Administration does not at this point favor legislation which would authorize contract term adjustments. At present, defaults are imminent on no BLM contracts and on only those few expiring Forest Service contracts on which the purchaser is either unable or unwilling to meet the modest conditions for a two-year extension. The Administration holds the view that if contracts are not

operated within the periods of extension currently available by administrative action that the contracts should be defaulted and that the defaulting purchasers should pay whatever damages may accrue by reason of default. Timber subject to the defaulted contracts should be resold in conjunction with the regularly prescribed timber sale program. In short, since it is presently impossible to fashion relief that treats all purchasers of Federal timber, all segments of the industry, and the general public with fairness and equity, the only appropriate action is not to interfere with the obligations and consequences created by existing contractual commitments.

The Administration does suggest, however, that both the Secretaries of Agriculture and the Interior be granted new authority to deal with defaulted contracts. The Secretaries could be authorized to enter into and to amend agreements with purchasers and their sureties who have incurred obligations for damages by reason of such default. Such agreements could specify the schedule for payment of damages, the rate and schedule for interest payments, the security, if any, to be provided, conditions under which subordination of the security will be granted, and other provisions as the Secretaries and defaulting purchasers and their sureties might agree. The purpose of such authority would be to assure an eventual recovery of damages without forcing the defaulter into bankruptcy. It is not intended that such new authority extend relief on the basis of individual situations. Rather, the amount of damages would be determined either by resale of the timber subject to the defaulted contract or uniformly applicable rules prescribed by regulations developed by the respective Secretaries under the authority of the new legislation. It is anticipated that the availability of such authority could save many businesses and prevent much expensive and time-consuming litigation.

In summary, Mr. Chairman, the Administration suggests legislation to provide authority to the Secretaries providing flexibility to deal with a defaulter's obligations for damages. The unharvested timber will find its way into the market place by being reoffered to other buyers. The obligation of the defaulting buyer for damages will become fixed. The appropriate Secretary, however, rather than implacably pursuing recovery of the amount owed would, in the exercise of discretion conferred upon him, be able to reach agreement with the defaulter and his surety for payment of the obligation on such terms as would

allow the defaulter to remain in business. The United States and the counties which share in timber sale receipts thus would eventually recover the original contract price in many cases, although somewhat later than was originally expected.

We believe the recommendation we are making is fair to those sectors of the forest products industry who have opposed any remedy for the purchasers of high-priced timber relieving them of all liability to perform their contracts. Volumes of defaulted timber would be put back on to the market as part of the regular timber sale program, thereby avoiding an oversupply of lower-priced stumpage which could result in an undue competitive advantage to its purchasers.

One final point before closing. Since 1974, there has been a provision in the Interior and Related Agencies annual appropriations measure which prohibits the export of unprocessed logs originating from Federal lands west of the 100th meridian. Because of the large volumes of Federal timber under contract at high prices in the West, it is obvious that the holders of such contracts would benefit from access to additional prosective markets for the next six to eight years.

In closing, Mr. Chairman, I thank you for the opportunity to present the views of the Administration on this bill. We look forward to working closely with the Congress as the legislation is developed. I would be happy to answer the Subcommittee's questions.

[Subsequent to the hearing, the subcommittee staff submitted questions to the Forest Service, the questions and answers thereto follow:]

Question 1. On a number of occasions, President Reagan and other members of the Administration have expressed their unequivocal opposition to bailouts for particular industries. Housing proved to be no exception as the President vetoed the Lugar housing assistance bill. How does the Administration position on S. 2805 square with the President's position on bailouts?

Answer. The Administration's position on S. 2805 is fully consistent with that of earlier stated positions on assistance to economically distressed sectors of the economy. In opposing the 3 provisions in S. 2805 that would provide relief to the forest products industry, the Administration is reaffirming its belief that there should be no legislative relief to one sector of the economy which is not available to other troubled sectors.

Question 2. Who would be the primary beneficiaries of a proposal such as S. 2805, or any other program which would allow the termination of timber contracts?

Answer. National Forest System and public land timber purchasers holding high-priced contracts which cannot be economically operated under current and foreseeable market conditions, and which are concentrated in western Oregon and Washington and northern California. About two-thirds of the sales are held by small business firms.

Question 3. What will happen to these companies if terminations are not provided?

Answer. It is difficult to say since the economic circumstances and liabilities of the individual firms vary widely. Some firms have the resources to meet potential damages if the contracts should default; others do not. We would expect bankruptcies to be concentrated in the smaller firms.

Question 4. Can you describe some of the alternatives that might be used to alleviate the problem without distorting the market price mechanism or violating the sanctity of contracts?

Answer. The three alternatives in the bill cover the range of alternatives available. Further extensions, for which there is currently administrative authority, can provide increased flexibility for adjusting operations to the economic conditions. Such extensions, if accompanied by sales levels which result in continued moderation of bidding will enable many firms to work out of their problems, assuming there is a reasonble recovery of markets in the next few years.

Question 5. What kind of signal do you think the kind of bailout that the administration is advocating would send to other segments of our economy?

Answer. The single form of assistance suggested by the Administration to aid the purchasers of Federal timber; namely, the revision of requirements for recovery of damages on defaulted contracts, cannot be considered, in any sense of the word, as a bailout. We seek only to ease the financial burden on the defaulting purchaser, avoiding forcing him into bankruptcy.

Question 6. Would you support the type of legislation that was recommended in the industry proposal that fell apart shortly before S. 2805 was introduced? As I understand, it would allow termination of up to 40 percent of outstanding timber contracts, plus one sale, would allow transfer of purchaser road credits between national forest, and would limit the amount of timber that could be harvested from the national forest in Region 6 for the next two years.

Answer. Inasmuch as the proposals contained in the forest products industry draft legislation have not been introduced, we do not wish to comment on them. We point out that one part of that proposal, contract termination, also appears in S. 2805. The Administration opposes contract termination.

Question 7. It is my understanding that the industry is still divided over the need and the desirability for timber contract relief. Why do you think that anyone in the timber industry would oppose legislation that may help a segment of their own industry?

Answer. The timber industry is a highly competitive industry. Particularly during periods of constrained markets, relative market advantages are guarded very closely. Because of the high prices paid for stumpage (i.e standing timber) in the West, the southern timber industry enjoys a competitive advantage in many of the nation's most active markets. Measures which reduce costs for western producers are viewed as reducing that advantage.

Question 8. Some industry analysts have proposed that the current market downturn may thus merely move up the date when some of the mill capacity in the Pacific Northwest may close. Would you agree with this assessment?

Answer. There is an on-going reduction of harvest levels on private lands on the West Coast as the removal of existing old-growth sawtimber stands is completed. If current harvest levels on Federal timberlands in the area are maintained, the reduction in mill capacity will occur. However, such a reduction is not inevitable. There is an adequate inventory of sawtimber on the the Federal timber lands to permit harvest increases which could largely offset anticipated reductions in private land harvest levels.

Question 9. It is true even though the Forest service has reduced appraised prices, that bid rates in these particularly troubled areas are still several times higher than the appraised price, and that sales are actively purchased?

Answer. Yes. Competition for available timber remains high. However, both appraised and bid prices have declined substantially. Bid prices averaged in excess of $350 per thousand board feet on the west side of Oregon and Washington from 1978 to 1981. Bid rates in this area in May and June of 1982 were about $100 per thousand board fee.

Question 10. How will timber sales level for FY 83 of 12.3 billion board feet affect timber sales in western Oregon?

Answer. We expect to sell about 5.4 billion board feet of timber in Oregon and Washington; this will mean a slight increase in the program in western Oregon and Washington. We anticipate that this supply of timber and the changes made in sale procedures will result in bid rates which will permit purchasers to operate under current market conditions.

Question 11. Has the Forest Service or BLM undertaken any study of the anticipated effects that further extensions or contract terminations would have on revenues received by county governments under the payment-in-lieu-of Tax Act?

Answer. Timber purchasers are under considerable pressure to operate their mills. They need a flow of cash to meet their financial commitments. They want to retain trained crews. Therefore they can be expected to operate to the extent the market will absorb their products. Given the current market situation it is doubtful that extensions significantly affect actual harvest levels; thus, extensions will have little effect on revenues to county governments. They simply avoid forcing purchasers into default. We must note that payments to counties of a portion of National Forest timber sale receipts is made under authority of 1908 and 1911 Acts, not the Payment-In lieu-of-Taxes Act.

Question 12. One proposal that has been advanced would grant to a group of firms the "ineffective purchaser road credits" they have held dating back to 1975 as a public timber subsidy. (Mr. Peterson) would you explain just what this would mean? Would not the Forest Service, in effect be paying to have the timber cut?

Answer. Timber purchasers build the bulk of the National Forest transportation system under terms of their timber sale contracts. In return for the construction of the permanent roads, they receive a credit which may be used to pay for timber. In some instances, the value of timber to be removed on a timber sale is inadequate to cover the full cost of the road. In this instance the credit which is earned by constructing the road cannot be utilized to pay for the timber and is termed "ineffective purchaser credit". The purchaser has invested his money to build a permanent facility for the Government but receives no credit for it. The proposals which have been discussed would permit the purchaser to transfer such ineffective purchaser credit to a sale where it would be effective. It would not put the Forest Service in a position of, in effect, paying to have the timber cut.

Question 13. Proposals have been put forth (as in S. 2805) that would allow termination or other adjustments to contracts. Is there a precedent for any action by the agency that would result in adjustment to the sale price in the contract?

Answer. A 1935 Act (49 Stat. 158) authorized the Secretary of Agriculture to terminate timber sale contracts upon request by the purchaser who had to make such requests within 1 year of date of enactment of that Act. Other than that Act, we know of no precedent outside of normal contract provisions for reducing the contract price on a Federal timber sale contract in response to depressed market conditions. We understand that the States of oregon and California have authorized price reduction on timber sale contracts on State lands.

Question 14. Can you see any benefits to the agency if Congress were to allow price rollbacks on existing contracts as provided for in S. 2805?

Answer. Rollbacks would permit operations to resume on some sales. However, such rollbacks would be grossly inequitable and would seriously damage the credibility of the competive bidding process.

Question 15. Has the Forest Service or BLM conducted any benefit-cost analysis of the various proposals for timber contract relief? If so, have these been made available to Congress?

Answer. The Forest Service has made some attempt to estimate the cost of various relief proposals and the data developed has been provided to the Congress. Unfortunately, the high level of uncertainty about the outlook for housing over the next few years and lack of data on the financial position of individual firms makes it difficult to assure the reliability of such estimates.

Question 16. I understand that the Forest Service has conducted a survey of uncut timber sales and has calculated the "break even point" for the companies that would operate these sales. Could you tell us about this study and describe the method by which the agency arrived at its conclusions? Also, would you provide a copy of the study for the committee?

Answer. The "break even point (BEP)" stumpage value is the value at which all the purchaser's cost of production (including stumpage) would equal product average selling price. This BEP was developed for the average sale in each subregion using data collected by the Government from selected timber sale purchasers and averaged for the subregion. Subregion refers to a portion of a Forest Service Region. Region 1 west is the western part of Montana and northern Idaho. Region 5 north is northern California. Region 6 westside lies west of the summit of the Cascade range in Oregon and Washington. For those areas analyzed, the BEP was compared to the individual timber purchaser's timber sale stumpage values by year of contract termination. Firms and volumes were then broadly categorized by the BEP relationships developed. The analysis summary is provided.

Question 17. Has the Administration estimated the cost of providing timber contract relief to all of the companies that might be eligible? If so, what are these estimates?

Answer. The Forest Service estimated that a probable maximum of 8.7 billion board feet might be terminated under a contract relief provision that allows purchasers to terminate up to 40 percent of the volume under contract. This volume was valued at an estimated $1.3 billion. The analysis summary is provided.

Question 18. If the Administration is given the authorities in S. 2805 to modify timber contracts, what will be the eligibility requirements for relief to distressed companies?

Answer. The bill requires the establishment of "economic hardship" as the determination of eligibility. We would not favor establishing eligibility requirements based on this factor. The Forest Service does not have enough personnel with skills to evaluate the financial qualifications of firms which may seek termination in a timely manner. We know of no way to administer such eligibility criteria in a manner which would not distort the relative competitive positions of Federal timber purchasers.

Question 19. If contract terminations are allowed, would the Administration recommend that penalties be required of companies that choose to terminate?

Answer. If contract terminations were allowed, the purchaser of the sales should be held liable for the costs to the Government of terminations and reselling the timber.

Question 20. If additional relief is not given, what will be the anticipated effect on the timber industry in western Oregon?

Answer. There will be a period of serious stress and it can be anticipated that a number of firms will default their Federal timber sale contracts and some will become bankrupt. The exact number is difficult to predict. A consolidation of the industry would occur with a reduction in the number of firms, concentrated in the smaller size segment of the industry.

Question 21. By region, for each of the following alternative proposals, (1) extensions, (2) terminations, and (3) price rollbacks, what are the number of companies that would be involved, the estimated cost to the U.S. Treasury, the effect on timber sales and harvest levels, the effect on local governments, and the estimated impact of a changed timber supply and demand situation on other regions of the country.

Answer. Because of the uncertainties and speculations necessarily involved in estimating individual company situations, estimates by company or number of companies is not feasible. Rather than by company, estimating is done on an overall subregion or region timber volume basis. Additional analyses are underway. Initial analysis for the termination proposal is provided in the answer to question 17.

Question 22. Does the Administration feel that it is sound public policy to permit firms holding federal timber contracts to terminate them?

Answer. No. There should be no relief to one sector of the economy that is not available to all sectors.

Question 23. Is the Administration concerned with the equity of timber contract adjustment programs on firms holding chiefly private timber?

Answer. Yes. It is the matter of equity and fairness to other segments of the forest products industry, and to the general public as well, that leads the Administration to oppose relief to the purchasers of Federal timber as provided in S. 2805.

Question 24. To what extent are Canadian timber exports subsidized and how have these imports affected the U.S. markets for timber?

Answer. We do not believe that it would be appropriate to comment on the issue of subsidization of Canadian timber exports since an examination of this issue is now underway by the International Trade Commission, Department of Commerce.

Question 16 response—Forest Service timber sale contract situation

Harvesting of National Forest timber under contract fell to less than 9 billion board feet in calendar year 1980 and continued at a low volume in CY 1981. The principal users of this timber, the softwood lumber and plywood industries, have constrained their timber harvest and lumber and plywood production because of the current and extended period of low level of housing construction.

The low demand for softwood lumber and plywood has forced down the selling price for these products at the mill. However, costs of production have continued to rise. The price paid for timber stumpage is one of the producer's costs. In some areas, the cost of National Forest stumpage has become a major cost to the producer because of the unprecedent high values bid for this stumpage since 1978. The spread between the advertised price and the high bid value has been largest in Oregon, Washington, northern California, northern Idaho, and western Montana. Both the amount of timber purchased and the high bid value have been greatest in western Oregon and western Washington, the Douglas-fir region (Df).

The economic climate has changed significantly and so has the timber producer's situation. Many have high priced National Forest timber sales under contract. The prices were bid competitively during economic times that were entirely different from the current climate. These National Forest timber purchasers are caught in a squeeze from which there seems no relief. Costs keep increasing and markets have evaporated.

The producers hardest hit are those whose major supply of timber is National Forest timber which was purchased at the very high stumpage values. These producers can operate only at a loss under current softwood lumber and plywood prices. Under these conditions the timber producer with the highest production costs and the slimmest profit margin is forced to minimize losses by not producing.

The details of the situation facing the individual timber producers are largely unknown, and may vary widely from the average. Among the unknown factors are:

How efficient is the producer.

What other timber at lower prices does the producer have available for cutting along with the high priced timber.

Does the producer enjoy a specialized market yielding higher end product prices.

Are the producer's plants and equipment already fully depreciated, thus giving it lower operating costs.

Some indicators of the situation facing National Forest timber purchasers can be set forth from a broad review of timber sales under contract as of September 30, 1981. This review covered National Forest timber sales in Oregon, Washington, northern California, northern Idaho, and western Montana. Differentiation is based on the producer of average efficiency. Costs and selling prices used to determine the average producer were collected from National Forest timber purchasers. As stated above, there are unknowns which could affect the differentiation. Based upon these qualifications, there are apparently National Forest timber sales bid so high, particularly in northern California, western Oregon, and to a lesser degree, western Washington, that they could not profitably be harvested, even under the best markets ever experienced.

National Forests included in the review were: Region 1—Idaho Panhandle; Clearwater; Nezperce; Flathead; Kootenai. Region 5—Klamath, Mendocino; Shasta-Trinity; Six Rivers. Region 6—All Forests.

FOREST SERVICE TIMBER SALE CONTRACT SITUATION, SELECTED SUBREGIONS

Subregion	National Forest timber purchasers included in analysis		Remaining timber sale volume under contract [1] as of Sept. 30, 1981 in million board feet—categorized by stumpage values related to production break even point (BEP)—no profit [2]			
				Stumpage greater than BEP		
	Size	No.	Stumpage less than BEP	Less than 150 percent of BEP	Greater than 150 percent of BEP	Total volume
R–1 West (5 forests)	Large	10	1,259.1	418.8	33.3	1,711.2
	Small	17	316.4	56.7	9.6	382.7
	Total	27	1,575.5	475.5	42.9	2,093.9
R–5 North (4 forests)	Large	15	252.5	329.7	790.7	1,372.9
	Small	30	159.8	387.0	339.1	885.9
	Total	45	412.3	716.7	1,129.8	2,258.8
R–6 Eastside (all forests)	Large	21	1,640.8	651.2	493.3	2,785.3
	Small	35	889.5	413.9	394.3	1,697.7
	Total	56	2,530.3	1,065.1	887.6	4,483.0
R–6 Westside (all forests)	Large	13	66.1	1,880.4	410.8	2,357.3
	Small	68	778.8	2,797.0	992.7	4,568.5
	Total	81	844.9	4,677.4	1,403.5	6,925.8
Total volume			5,363.0	6,934.7	3,463.8	15,761.5

[1] Is not total volume under contract. In this analysis volume is categorized and stumpage values averaged by the calendar year in which the contract is scheduled to terminate (as of Sept. 30, 1981). Thus the volume reported in any year would likely have lower valued stumpage as well as higher valued stumpage in the average.

[2] The break even point (BEP) stumpage value is the value at which all the purchasers costs of production (including stumpage) would equal product average selling price. Stumpage value is the contract high bid value. For comparable values on stumpage rate adjustment timber sales the average amount of stumpage price decrease has been added into the BEP stumpage value.

The BEP increases over time. This is based on two assumptions. First, the rate of housing construction will increase moderately through the 1980's. Second, there will be an inflation-generated product price increase averaging 4 percent per year.

Following are the BEP stumpage values used in the analysis:

	R–1 West	R–5 North	R–6 Eastside	R–6 Westside
Calendar year:				
1982	$50	$100	$100	$200
1983	100	100	150	250
1984	150	150	200	300
1985	150	150	200	300
1986	200	200	200	350
1987	200	200	200	350

INDICATORS OF THE TIMBER PRODUCER'S SITUATION FOR PURCHASERS OF NATIONAL FOREST TIMBER

Subregion and firm size	Percent of firms with 60 percent or more of volume valued greater than BEP	Volumes in million board feet [1]—Categorization of seriousness of the timber producer's situation					
		Very serious [2]		Serious [3]		Not so serious [4]	
		Percent of firms	Volume held	Percent of firms	Volume held	Percent of firms	Volume held
R–1 West (5 forests):							
Large	10	0		0		100	1,711.2

INDICATORS OF THE TIMBER PRODUCER'S SITUATION FOR PURCHASERS OF NATIONAL FOREST TIMBER—Continued

Subregion and firm size	Percent of firms with 60 percent or more of volume valued greater than BEP	Volumes in million board feet [1]—Categorization of seriousness of the timber producer's situation					
		Very serious [2]		Serious [3]		Not so serious [4]	
		Percent of firms	Volume held	Percent of firms	Volume held	Percent of firms	Volume held
Small	53	0	.....	0	.....	100	382.7
All	37	0	.....	0	.....	100	2,093.9
R–5 North (4 forests):							
Large	80	0	.....	7	180.2	93	1,192.7
Small	80	7	276.4	3	124.5	90	485.0
All	80	4	276.4	5	304.7	91	1,677.7
R–6 Eastside (all forests):							
Large	48	5	35.7	14	440.4	81	2,309.2
Small	57	3	59.9	9	271.0	88	1,366.8
All	54	3	95.6	11	711.4	86	3,676.0
R–6 Westside (all forests):							
Large	100	0	.....	31	1,501.8	69	855.5
Small	85	6	170.2	38	3,131.1	56	1,267.2
All	88	5	170.2	37	4,632.9	58	2,122.7
Summary volume			542.2		5,649.0		9,570.3

[1] Volumes under contract as of Sept. 30, 1981.

[2] Benchmarks for the "very serious" category are: 60 percent or more of the total volume under contract has an average stumpage value which exceeds the BEP stumpage value in the year in which the timber sale contracts terminate. Volume under contract with average stumpage values (in year in which contract terminates) which exceeds 150 percent of the BEP stumpage value amounts to 3 years or more of the average volume that the National Forest timber purchaser annually harvests from National Forest timber sales in that subregion.

[3] Benchmarks for the "serious" category are: 60 percent or more of the total volume under contract has an average stumpage value which exceeds the BEP stumpage value in the year in which the timber sale contracts terminate. Volume under contract with average stumpage values (in year in which contract terminates) which exceed the BEP stumpage value amounts to 3 years or more of the average volume that the National Forest timber purchaser annually harvests from National Forest timber sales in that subregion. This includes all volume over BEP, including that volume in the "very serious" category.

[4] The "not so serious" category includes all firms which do not meet the benchmarks for the other two categories.

There is considerable interest in doing something to restore production at mills in the Df region. All the proposals basically address the supply of timber rather than stimulating demand. Several alternative palliatives have been tested in the Oregon State University-Forest Service, USDA, Timber Allocation Model (TAM). This econometric model is regionally oriented on both the supply and demand sides. There are limitations to what can be tested and what answers can be gotten from the testing. However, some relationships and trends are clearly highlighted in the results.

1. A sustained rising level of housing construction, i.e., and increase in demand for softwood timber, is the basic ingredient to produce an improvement in the economy of the timber production sector, both nationally and regionally.

2. Over the ranges of options and housing starts tested, changes in the average stumpage price of Federal Government softwood timber in the Df region have little effect on either the national average prices of softwood lumber and softwood plywood or in the volume of softwood produced and consumed.

3. Lowering the prices of Federal Government timber under contract in the Df region does have effects within that region and on the volume of softwood sawtimber imported from Canada. The effects are short lived, lasting only about 4 years. Principal effects are:

a. Some harvest is shifted from private ownership timberlands to Federal Government timberlands until the excess Federal Government backlog is harvested. Then the harvest balance is restored.

b. Lowered Federal Government stumpage prices cause lower stumpage prices for private timber within the Df region.

c. The combination of smaller harvest volumes and lower stumpage prices reduces income to private timberland owners in the Df region.

d. Lower stumpage prices in the Df region improves that region's competitive position relative to Canada. As a result Canadian softwood lumber imports decline until the Federal Government backlog is harvested.

e. Current holders of high priced Federal Government timber improve their cost/revenue situation, may be able to resume timber harvest and production, and may recapture a share of the limited timber supply/demand equilibrium volume.

f. Current holders of lower priced Federal Government timber and private timber who have continued to produce in the limited market will lose some of their share of the market to those producers who have their high priced timber stumpage rates reduced.

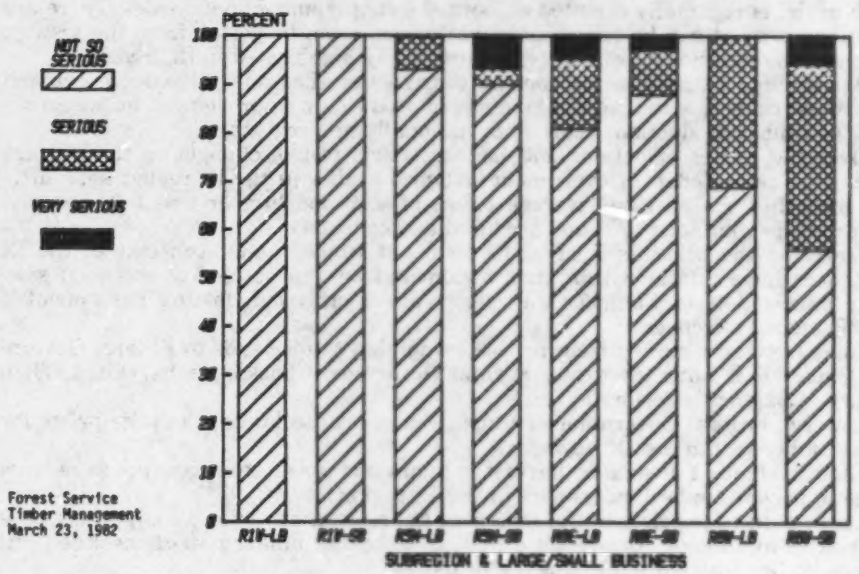
g. Overall employment levels in the Df region would be adjusted and shifted from one location or mill to another to the same extent that timber harvest shifts from one producer to another. The only general increase in employment level within the Df region would result from the temporary shift of production from Canada to the Df region.

An increase in the demand for softwood timber, i.e., housing construction, is required to bring about sustained, substantial increases in employment levels.

98-286 O - 82 - 5

SERIOUSNESS OF PROD.'S SITUATION

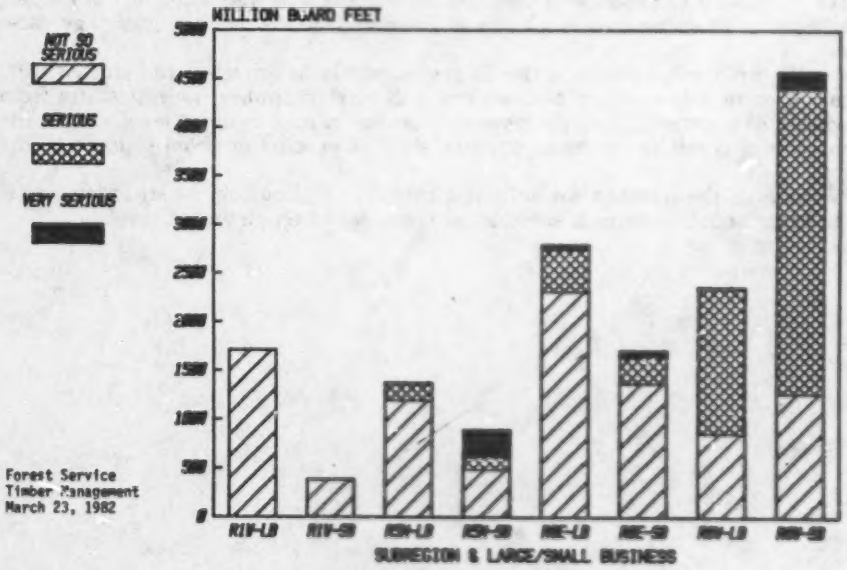
PERCENT OF FIRMS BY CATEGORY



Forest Service
Timber Management
March 23, 1982

SERIOUSNESS OF PROD.'S SITUATION

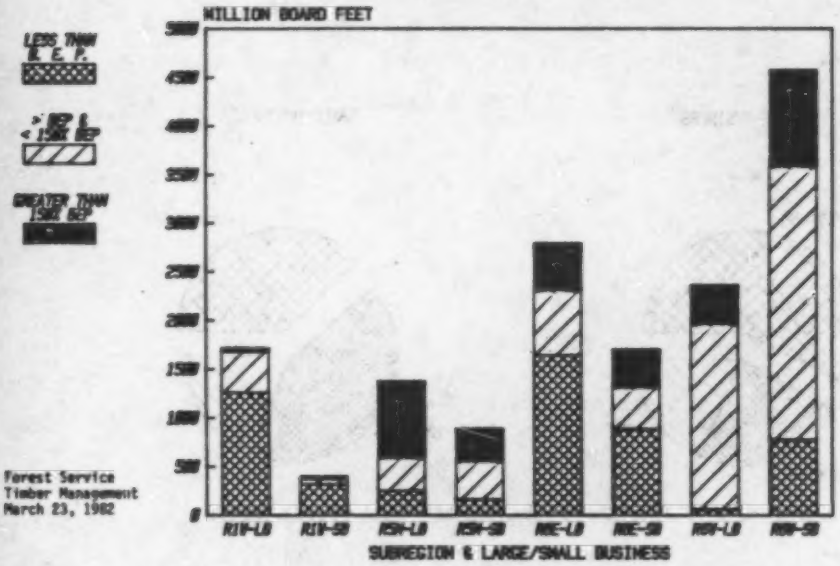
VOLUME HELD BY FIRMS BY CATEGORY



Forest Service
Timber Management
March 23, 1982

UNCUT VOLUME UNDER CONTRACT

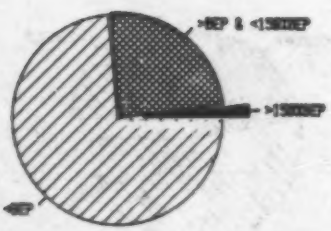
CATEGORIZED BY STUMPAGE B.E.P.



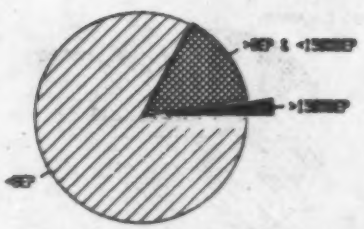
Forest Service
Timber Management
March 23, 1982

R-1 WEST VOLUME UNDER CONTRACT

LARGE BUSINESS



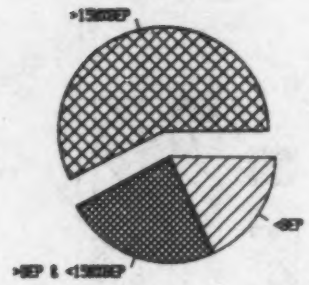
SMALL BUSINESS



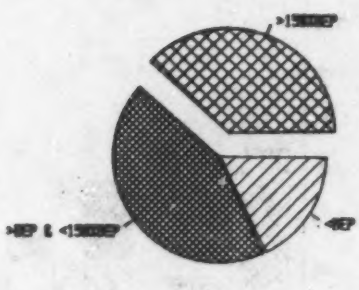
Forest Service
Timber Management
March 23, 1982

R-5 NORTH VOLUME UNDER CONTRACT

LARGE BUSINESS



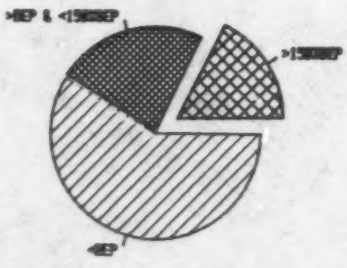
SMALL BUSINESS



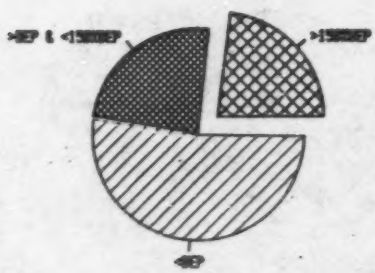
Forest Service
Timber Management
March 23, 1982

R-6 EAST VOLUME UNDER CONTRACT

LARGE BUSINESS

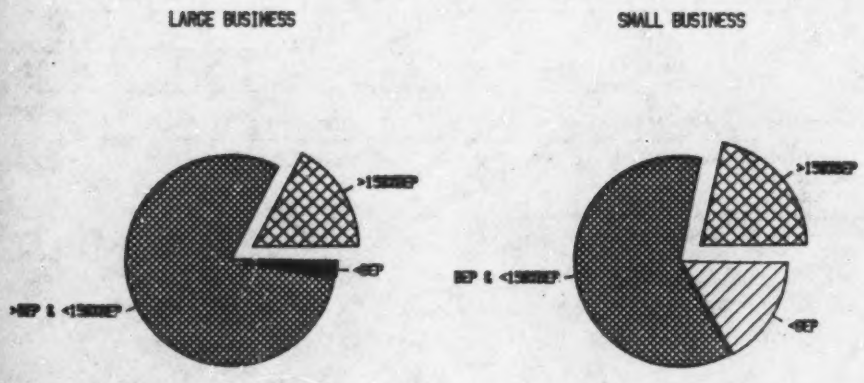


SMALL BUSINESS



Forest Service
Timber Management
March 23, 1982

R-6 WEST VOLUME UNDER CONTRACT



Forest Service
Timber Management
March 23, 1982

12

Question 17 response

SUMMARY—PROBABLE VOLUME AND VALUE OF TIMBER ANTICIPATED TO BE TERMINATED UNDER DRAFT LEGISLATION

Unit	Fiscal year 1981 uncut volume under MMBF	Maximum percent to be canceled	Maximum volume to be canceled MMBF	Reduce volume by 25 percent for probable MMBF [1]	Value			
					Average per MBF of cancel	Average per MBF of resale [2]	Net loss to government	
							Dollars per million board feet	Millions
Region 1:								
West	[3] 2,094	39	[4] 814	611	$134	$94	$40	$24.4
All others	1,231	36	443	332	76	25	51	16.9
Subtotal	3,325	38	1,257	943	114	70	44	41.3
Region 2	1,057	36	381	286	14	10	4	1.1
Region 3	995	36	358	268	103	70	33	8.8
Region 4	750	36	270	203	34	25	9	1.8
Region 5:								
North	[3] 2,259	52	[4] 1,175	881	260	101	159	140.1
All others	3,625	36	[4] 1,305	979	242	80	162	158.6
Subtotal	5,884	42	2,480	1,860	251	90	161	298.7
Region 6:								
East	[3] 4,483	36	[4] 1,630	1,222	260	100	160	195.5
West	[3] 6,926	49	[4] 3,407	2,555	398	144	254	649.0
All others	4,886	20	977	733	203	70	133	97.5
Subtotal	16,295	37	6,014	4,510	329	120	209	942.0
Region 8	1,988	15	298	224	113	80	33	7.4

SUMMARY—PROBABLE VOLUME AND VALUE OF TIMBER ANTICIPATED TO BE TERMINATED UNDER DRAFT LEGISLATION—Continued

Unit	Fiscal year 1981 uncut volume under MMBF	Maximum percent to be canceled	Maximum volume to be canceled MMBF	Reduce volume by 25 percent for probable MMBF [1]	Value			
					Average per MBF of cancel	Average per MBF of resale [2]	Net loss to government	
							Dollars per million board feet	Millions
Region 9	1,937	20	387	290	$34	$25	$9	$2.6
Region 10	440	20	88	66	67	20	47	3.1
Total	32,671	35	11,533	8,650				1,306.8

[1] Developed from timber sold data and weighted to upper ⅓ of price range.
[2] Based on recent sale averages.
[3] Selected purchasers only.
[4] Developed from examination of individual purchaser's situation.

STATEMENT OF PETER C. KIRBY, THE WILDERNESS SOCIETY

Mr. Chairman, my name is Peter C. Kirby, the Coordinator of the Forest Management Program at The Wilderness Society. The Wilderness Society, a nationwide group headquartered in Washington, D.C., is dedicated to principles of sound and balanced multiple-use management of the nation's forest and range lands and to protection of the unique values of our remaining public wildlands. Assisting in the preparation of the testimony is Al Sample, the forester of the Forest Management Program. This testimony is also being submitted on behalf of the Natural Resources Defense Council, a nationwide group headquartered in New York City, and dedicated to protecting America's endangered natural resources and to improving the quality of the human environment. Its forest specialists include Kaid Benfield in Washington, D.C. and Trent Orr in San Francisco.

We appreciate this opportunity to testify on S. 2805, a bill to provide for the termination, extension or modification of contracts for the sale of federal timber. At the outset we commend this committee and the sponsors of the bill for seeing that these essential hearings are being held. The sponsors may be well-advised to see that field hearings are provided as well so that all the affected groups can voice their views about the significant impacts of this legislation. Our position on this legislation is that we generally support contract termination as the most appropriate relief for the timber companies and communities that are sorely distressed by the sharp drop in housing construction and timber prices. As we will explain, we have no objection in principle to legislation allowing for the termination of existing contracts provided that needed safeguards ensure that the relief is economically sound and environmentally responsible.

The Wilderness Society and NRDC are very sensitive to the economic problems besetting the Northwest because of high interest rates, a collapsing timber industry, and record unemployment. We want to help shape measures that lessen the human and economic impacts of this recession and bring about eventual economic recovery. Our most constructive role in this current debate will be to suggest ways, as noted, that legislation can be improved environmentally and economically. If these improvements are made there can be greater public consensus in support of a bill and a greater likelihood that

needed relief can be afforded the Northwest. The following are our major points for improvement of S. 2803:

1. There should be a forest-by-forest moratorium on new timber sales in roadless areas until terminated sales in roaded areas are reoffered for sale. Section 2(1) of the Hatfield legislation authorizes the Secretaries to terminate contracts entered into prior to January 1, 1982. According to the latest estimates, more than 10 billion board-feet are now under contract in Oregon and Washington at prices that cannot be profitably harvested. When these contracts are terminated it makes strong economic and environmental sense that they should be reoffered first before brand-new sales are made available.

From an economic point of view, the terminated sales should be reoffered first because of the obvious cost savings to the government. These sales have already received environmental study; timber volumes and sale designs have already been surveyed, and personnel have already administered the sale at least once. Thus, from the standpoint of efficiency alone these sales should be recycled before new ones are offered. In addition, road access costs to the government and the companies would be less for recycled sales in roaded areas than for new sales in areas not presently roaded.

From an environmental point of view, the reoffering of terminated sales in roaded areas will allow for a reduction in road construction mileage needed in the next few years. Road construction is one of the single biggest causes of environmental damage to the National Forests; it often results in serious stream siltation, fisheries and wildlife habitat damage, and visual scarring, among other effects. By selling the terminated sales first, the Forest Service can still offer the timber levels set by Congress through appropriations and cause much less environmental damage.

In addition, roadless areas designated non-wilderness in RARE II would not need to be entered until the terminated sales are all reoffered. This outcome would benefit all parties conferring on wilderness legislation in the Northwest, including the Congressional delegations. They would gain additional time for careful study of areas under consideration.

2. Contract terminations should be the exclusive remedy for uneconomic contracts, not further contract extensions or price reductions. We urge that Sections 2(2) and (3) of the Hatfield bill, allowing for time extensions and

price reductions on existing contracts, be deleted. Contract termination appears to us to be the only remedy that is needed to address the current crisis. If uneconomic contracts are terminated, then the companies now holding them will not face default. And if the contracts are then reoffered, they will be sold at current market prices, allowing for work and employment to resume.

Extensions and price reductions are not needed at all if termination authority is granted and used. Moreover, these additional provisions have the effect of rewarding the speculators who bid up the prices of contracts in the late 1970's. With extensions or price reductions, these speculative bidders get to keep their contracts and profit from them. It is not in the public interest to do so. Overbid contracts should be terminated so that all qualified firms can re-bid.

3. Conservation groups strongly oppose any uneconomic and environmentally-damaging road credit provisions being added to this bill. Pre-introduction drafts of relief legislation contained a variety of provisions extending virtually limitless benefits to timber companies for the construction of roads to service timber sales. Under current law, the federal government reimburses timber companies for the costs of building timber-sale roads, but not for road costs beyond the value of the timber. Earlier drafts of this relief legislation would have changed the law to give timber contractors credit for all road construction costs, regardless of the value of the timber. Among our economic and environmental objections:

* The change in law would allow for an undisguised and uneconomic raid on the federal Treasure by the timber companies. Under present law, if a sale has $50,000 worth of timber, the company gets no more than $50,000 in reimbursement for road costs. If the law were changed as proposed in earlier drafts, the company could be reimbursed for $150,000, let's say, for costs in reaching this $50,000 worth of timber. The Treasury would, in effect, be paying timber companies to take federal timber for free. In our hypothetical case there would be no receipts (or only nominal amounts) going to the Treasury from the timber sale and $100,000 in revenues being taken from the Treasury because of the road construction subsidy. Even though road credits

effectively take money from the Treasury, they are not treated as appropriations by Congressional appropriations committees. Hence, the change in the law to allow all road costs to be reimbursed would allow for a major and unscrutinized drain on the Treasury.

* The change would reverse past efforts by Congress to bring economic common-sense to federal timber management. Section 6(k) of the 1976 National Forest Management Act directs the Forest Service to consider economic efficiency in making timber sales and investments. Limitless road credits, not even subject to the appropriations process, would remove major disincentives for the agency in pursuing highly uneconomic sales in remote areas. Section 6(k) of a basic forestry law could be subverted without Congress even knowing it.

* The change would draw demand for timber to the National Forests and away from private lands, which are generally more accessible and productive. Private landowners do not receive federal subsidies to road their lands for uneconomic timber sales. If limitless road credits are allowed in National Forests, companies will very logically look first to buy from the federal government, to the unfair disadvantage of the private landowners.

* Limitless road credits could disqualify millions of acres from deserved classification as wilderness. As we have explained, this change would threaten remote and inaccessible areas with heavily-subsidized road-building. Not only would the Treasury be the loser, but the many natural values of these wild places would be needlessly sacrificed.

* Lastly, this is not the first time that this type of road construction subsidy has been before Congress. Senator McClure introduced a similar provision in 1975 (S. 364) only to have it rejected by the fiscally conservative Ford Administration. This revived proposal should not be

THE WILDERNESS SOCIETY

FOUNDED IN 1935

August 26, 1982

The Hon. S.I. Hayakawa
United States Senate
Washington, D.C. 20510

Dear Senator Hayakawa:

On August 12, 1982 the Wilderness Society testified at hearings of the Forestry Subcommittee of the Agricuture Committee, which you chaired, on S. 2805. S. 2805 would provide for contract relief for purchasers of national forest timber. During our testimony we stated our strong opposition to provisions for the validation of "ineffective" timber purchaser road credits and their transfer between national forests and between timber purchasers. At this time we would like to supplement our testimony with the following details of our opposition to these provisions and specific responses to points raised by timber industry testimony and submissions. We request that this supplement be made part of the hearing record.

Under current law, purchasers of timber sales receive credit for road construction costs only up to the appraised value of the timber in the sale. In other words, if a timber sale is valued at $100,000 and the estimated cost of the road required to access the sale is $110,000, the purchaser is relieved of paying the Forest Service the $100,000 for the timber but is not credited for the additional $10,000, termed an "ineffective road credit" (additional payment of minimal "base rates" for the timber must also be paid by the purchaser in cash). Such timber sales are known as "deficit sales" and are offered by the Forest Service only at the specific request of a timber purchaser.

In 1975, legislation was introduced by Senator McClure that would

have made all road credits "effective", meaning the Forest Service would be responsible for all road construction costs regardless of the value of the timber involved. Relating this back to our previous example, the Forest Service would not only forego the $100,000 in receipts for the timber it was selling but would actually pay the purchaser $10,000 in credits it could use on other national forest timber sales. Incredibly, this 1975 proposal would have been retroactive to 1965, requiring a massive governmental cash giveaway to past purchasers of hundreds of national forest timber sales. The measure was rejected by the Ford Administration.

In the pre-introduction drafts of the 1982 relief legislation, proposals for full road cost reimbursement were again put forward. In addition to the provisions of the 1975 proposal, the draft would allow the road credits to be fully transferable between national forests and between timber purchasers. This would allow integrated forest products corporations that operate in several regions of the country to accumulate road credits in marginal timber growing areas like the Rockies and use them to pay for timber in more productive areas such as the Pacific Northwest. It would also allow the brokering of road credits between companies, much like the brokering of tax credits under the 1981 tax legislation and with many of the same negative impacts on the federal treasury.

Road credit provisions have not been included in S. 2805. As we noted at the hearing, the conservation community is opposed to the addition of road credits provisions to timber relief legislation. Our testimony has outlined our major reasons for opposing the road credits changes. These include:

* the tremendous fiscal impacts of further increasing an already substantial public subsidy to the timber industry;

* the removal of major disincentives to pursuing highly uneconomic timber sales in remote areas;

* the increase in roadbuilding into presently roadless areas of the national forests, disqualifying them for any possible future consideration as wilderness;

In defense of the road credits provisions, timber industry representatives have stated that:

1) road building in marginal lands of the inland region will be limited because "the government will have to, in one way or another, more fully pay the cost of these roads;" (p. 17, statement of Industrial Forestry Association, et al) and,

2) various legal constraints will allow only for road construction in an "economically sound" and "environmentally-appropriate" manner. (p. 3, statement of Western Timber Association)

These statements and assurances do not hold up under careful analysis. Here is our point-by-point rebuttal:

1. There is little reason to believe that funding the entire cost of road construction from the Forest Service's timber purchaser credits fund will in any way hinder future roadbuilding. In FY 1982 the Timber Purchaser Credits fund was made an off-budget item. As such, expenditures are not tallied into the total budget picture and are not reflected in the level of the annual budget deficit. Although the appropriations committees can recommend a "cap" on timber purchaser credits, there is little incentive for them to hold the line on these expenditures since a high level will have no more effect on the budget deficit than a low level. In the Administration-proposed budget for FY 1983, the Timber Purchaser Credits fund used exclusively for timber sale access roads was equivalent to more than 90% of the total construction budget for the entire National Forest System. There is nothing to prevent that figure from growing even higher in the years ahead.

2. Legal constraints are not likely to assure that road building with full purchaser credit will be economically and environmentally sound. Current law is not effective in preventing highly uneconomic timber sales in the national forests. Section 6 (k) of the National Forest Management Act (NFMA) requires the Forest Service to identify lands economically unsuitable for timber production and to remove them from the timber base. However, the Forest Service has not interpreted this to mean that they cannot offer timber sales in which anticipated returns cannot cover the costs. On the contrary, economics is not

considered a limiting factor at all and is not a definitive decision element in planning timber sales.

Specifically, the NFMA rules adopted by the Forest Service call for timber lands to be ranked during the forest planning process by the degree of cost efficiency. The designation of lands as "unsuitable" for timber management, however, will be not on this cost efficiency analysis but on how much land is needed to achieve the goals of the forest plan, including timber production. This means that lands with a very low or even negative cost-benefit ratio for timber production may be deemed suitable for timber management in upcoming NFMA forest plans. Laws and policies which permit uneconomic timber sales under such vague regulations as these offer scant protection to the remaining roadless lands on our national forests.

We also cannot assume that adequate environmental protection regarding road building and timber management will be provided in upcoming forest plans. The timber industry points to various sections of the NFMA and its detailed implementation regulations as safeguards against the misuse of our national forests. However, as the Committee is aware, this Administration has targeted the detailed NFMA rules for reform and "streamlining". In our view, the changes proposed in February, 1982 would weaken the "safety net" of environmental protection in the planning process. If these changes are adopted, the rules would simply clear the way for increases in timber cutting with less consideration and concern for wildlife, wilderness, and public participation in resource decision-making.

In conclusion, current law and Forest Service policies do not prevent uneconomic timber sales on the National Forests. Nor can we be assured that upcoming forest plans will prevent unacceptable environmental impacts from resulting from timber sales in sensitive areas. Thus, we continue to oppose road construction subsidies which will lead to increased timbering in remote, roadless areas. As we have noted, the funding structure for timber road construction is among the most loosely controlled of any area in the federal budget. With the timber purchasers' primary financial disincentive to roading economically marginal areas of the national forests effectively removed, there is every reason to believe such roading would accelerate quickly and significantly. We would urge you to scrutinize closely this complex issue and prevent the proposed changes from

becoming part of this or any other legislation. Please feel free to call us if you or your staff have any additional questions.

Sincerely,

Peter C. Kirby
Coordinator
Forest Management Program

V. Alaric Sample
Forester
Forest Management Program

STATEMENT OF ROGER A. SEDJO, RESOURCES FOR THE FUTURE

I am Roger A. Sedjo, Senior Fellow and Director, Forest Economics and Policy Program, Resources for the Future, Washington, D.C. Resources for the Future (RFF) is a private nonprofit policy research organization specializing in natural resource problems. I speak today however on my own behalf, and my views do not necessarily represent those of RFF.

What I'd like to do today is comment on the situation in the timber industry that has precipitated the proposed legislation to authorize the Secretary of Agriculture to determine the extent to which timber sale contracts that were consumated during periods of very high timber prices ought to be enforced unaltered and the extent to which these contracts ought to be modified or terminated. I would like to present a broad overview of the economic forces that were at work when the contracts were made, the changes in the economic situation that have occurred in the intervening period, and the implications of changes upon the industry and the firms involved as well as upon the U.S. taxpayer.

The economic circumstances of the 1970s were unique in American history. This was a period of increasing inflation. While the annual

rate of price inflation at the onset of this period was about 5% annually, by the end of the decade it had risen to 12 to 14%. As we are all well aware, during that period the prices of real assets, be it land, housing, art objects, commodities or gold, experienced marked increases as both consumers and investors attempted to protect themselves from inflation by "fleeing" into real assets. With expectations for continued inflation unabated and real interest rates (the nominal rate less the rate of inflation) zero or negative, such behavior was appropriate, albeit quite risky.

During that period the price of timber assets behaved similarly to the prices of other real assets. The anticipation of continued rising inflation together with strong and rising demand for lumber, especially as reflected in the high level of housing starts, lead to large increases in lumber and timber stumpage prices. Throughout the 1970s the Forest Service offered sales of timber harvesting rights under a system of competitive bidding. These contracts involved the rights to harvest Federal timber at the agreed upon price together with obligations and also penalties which were associated with contract default. Unfortunately, the inflationary environment of the late 1970s and expectation of future inflation created an environment that lead to "excessive" bidding. After all, timber rights were a real asset that appeared to provide an ideal hedge against future inflation and thus the prices were subject to the same forces that drove up the prices of most real assets during that period.

Another factor contributing to this surge of what has been subsequently characterized as speculative bidding, was that timber sales contracts required very nominal downpayment with no payment due until harvest. Harvest was typically required within three to five years. However, unlike speculation that occurred in established commodity markets, the bidder was not required to make interest payments on the

difference between the downpayment and the outstanding balance. In essence the Forest Service financed the sale interest free. Thus many of the costs of speculation were shifted away from the buyer and onto the Forest Service. I should note here that the Forest Service has recently revised its timber harvesting procedure, in a manner that I generally applaud, by shifting a greater portion of the costs of holding the unharvested timber on to the buyer. This change should discourage excessive speculation in the future.

These two factors, the economy with rising inflation and the sales procedures which shifted the costs of speculation away from the buyer and onto the Forest Service (or indirectly the public), combined to create a situation that encouraged and promoted excess speculation and lead to timber sales prices that were far in excess of what today appears reasonable.

Since I believe that inflation experienced during the 1970s was largely the outgrowth of misdirected governmental policies, I believe it is correct to say that the problems faced by firms which today hold contracts at inflated prices are in large measure the outgrowth of governmental policy failures in the 1970s.

I should re-emphasize, however, that this was not a problem unique to the timber industry. The inflationary economy of the 1970s created an environment where most real assets became overpriced. Today we see various examples of the effects of the sharp reduction of inflation. The newspapers are replete with examples of homebuyers that are unable to meet their committments on balloon mortgages, farmers that are unable to make payments on land and equipment that was purchased in the heady environment of the late 1970s, firms that undertook contractual obligations of various sorts based upon the assumption that the inflationary economic environment of the 1970s would continue through the 1980s. In short, the problem that we are addressing here today which faces the

98-286 O - 82 - 6

timber industry is merely the manifestation of a more pervasive economy-wide problem that affects scores of sectors of the economy, i.e. disinflation and recession.

Given this situation, how might we begin to address the problem of the firms in the industry that hold these high-priced timber contracts. Surely one possibility is to provide for the termination, of some or all of these contracts. There are important reasons, however, to challenge the termination approach. By undoing the agreements that have been made we are imposing serious costs and damage upon the other parties in the contractual agreement. In the case of timber sales, Robert Wolf of the Congresssional Research Service has estimated that the termination of 40% of the contracts as proposed under the 40-60 arrangement would cost the Treasury, i.e. the U.S. taxpayer, up to $2 billion. In addition, the termination of existing contracts could significantly alter the competitive structure of the forest products industry by markedly enhancing the financial position of involved firms to the detriment of their competitors. This is clearly the reason why the industry has had such a difficult time developing a unified position on the termination issue. Also there are philosophical considerations. If this solution is appropriate for the firms in the forest industry, then why not renegotiate contracts for the whole host of other investors that have been hurt due to the precipitous changes that have occured in the economy? In addition, we must raise questions like: What are the long-term implications of such a decision to abrogate contracts in a private enterprise economy? Do we really want firms and investors to come to expect that their serious mistakes will often or even occasionally be offset by the intervention of the government to abrogate contracts?

The main economic argument for termination surely is the desire to avoid the costs and disruptions that large scale defaults might have on the industry. However, it is probably incorrect to say that contract

terminations will benefit the industry. Rather, terminations will benefit particular firms within the industry. Also, I should point out that the principal problem in the industry today is not the existing timber sales contracts but rather the principal problem is the lack of demand within the economy. If the housing industry improves markedly over the next 12 months, the health of the forest products industry will improve accordingly. However, should housing remain depressed over the next year, or worse, two or three years, the industry is likely to experience substantial failures regardless of how the termination problem is dealt with. It may be that the best solution is to allow market forces, in the form of the business cycle upturn, to rescue the involved firms.

How then ought we to approach the problem of contract terminations? Let me suggest two types of actions. The first relates to the Jones Act or more precisely the Merchant Marine Act of 1920 which prohibits intercoastal shipping on foreign bottoms. This Act, obstensively designed to protect the U.S. shipping industry, has in fact precluded the Pacific Northwest timber industry from marketing lumber on the U.S. east coast, while their Canadian competitors in British Columbia have developed a substantial trade, in excess of 2 million board feet annually, by shipping on low cost foreign carriers. Surely, faced with comparable shipping rates, the Pacific Northwest producers could displace some of the Canadian lumber. The improved market would directly benefit many of the firms currently holding overpriced contracts.

The second action I would suggest could be viewed as a direct alternative to termination. This would be to institute rather lengthy contract extensions, perhaps for periods of three to five years. While the firms would bear costs associated with these extensions, the longer time period should allow time for the market to improve. An exemption to the Jones Act for U.S. lumber would further improve the market. With a more buoyant market providing higher prices, the contracts could be

liquidated with far smaller losses than if the firms were forced to sell in the current market. In this manner the market, not the government, would provide the mechanism for relief.

TESTIMONY OF

GEORGE C. CHEEK
SENIOR VICE PRESIDENT, PUBLIC AFFAIRS
POTLATCH CORPORATION

I am George Cheek, a senior vice president of Potlatch Corporation. We are headquartered in San Francisco and manufacture a broad range of forest products in Idaho, Minnesota and Arkansas. We buy substantial quantities of timber from other ownerships, including the federal government.

My company is suffering, along with others, from the depression that has hit homebuilding, and we would welcome any measures that would truly improve the situation. However, real relief can come only with a homebuilding recovery and demand for products. Every other proposal we have seen would simply shift employment, and sales, from one region of the country to another.

The bill you are considering, S. 2805, is an example of this kind of proposal, and is grossly inequitable. We urge that you reject it.

Eight months have been spent in an effort to draft legislation that would represent an industry consensus. Those efforts failed because no way could be found to preserve equity or to prevent one region of the country from gaining an advantage over others.

Other, similar legislation has been enacted in several states. The purpose, in each case, was to improve the competitive position of companies in those states against others elsewhere. The general language in this bill is being described

as even-handed, but the application of its provisions would be nearly as restrictive as a bill limited to a single state.

It permits contract terminations. The benefits of this action, according to even its proponents in industry, would be concentrated in one small area of Oregon. The industry estimates that 81 percent of the benefit would be there, the Congressional Research Service estimate is 65 percent. A Forest Service study concludes that contract termination could reduce the value of all private timber holdings, and could improve the competitive position and the employment levels in coastal Oregon at the expense of every other softwood region in the U.S.

The bill would allow price modification. The value of this approach is virtually limited to western Oregon and Washington.

It also would permit contract term adjustment, which by itself would be of value to companies everywhere that purchase federal timber. However, if contract termination and price modification are included, it would be meaningless to companies outside that tiny western region. They would lose both employment and market share.

The eight months of discussions did identify a number of more equitable proposals, but only contract term adjustment is included in this bill. Administrative action was possible to make all federal contractors equal so far as contract extensions were concerned. Termination, combined with harvest limitations on the coastal region, to reduce but not eliminate its advantage, was suggested. Emergency federal loans were proposed for all timber-dependent counties, to be repaid from future timber receipts.

Each of these efforts at compromise was rejected by the

proponents of termination and price modification.

According to its supporters, this bill would not require the federal government to spend one nickel. However, it would allow administrators, without recourse to Congress, the authority to forgive contract obligations to the government that could reduce federal income. Proponents of the legislation have estimated this amount to be just over one billion dollars, the Forest Service puts the figure at $1.3 billion, and the Congressional Research Service estimates it could go as high as $2.6 billion.

If the Congress and the Administration favor a subsidy of this magnitude for the forest products industry, a program of mortgage assistance would provide greater general economic benefits to the country as well as provide stimulation to lumber and plywood production that would benefit all producers equally.

Finally, the bill would not discriminate among who would receive portions of this subsidy, although both Lockheed and Chrysler had to both demonstrate real need and submit to stringent restrictions.

We would support contract term adjustment, because it would provide a measure of relief to every federal timber contractor, as well as time for a normal housing recovery.

We urge that you reject the other proposals in this bill, because they will create economic inequities within our industry.

STATEMENT OF CHARLES H. THOMAS, JR., REPRESENTING SOUTHEASTERN LUMBER MANUFACTURERS ASSOCIATION

I am Charlie Thomas, Vice-president and co-owner of Shuqualak Lumber Company, Shuqualak, Mississippi, a small business lumber manufacturer. Shuqualak Lumber Company has 90 employees and processes approximately 24 million board feet of lumber annually. Since my firm purchases national forest timber, I am concerned with the outcome of this legislation.

I am appearing today on behalf of the Southeastern Lumber Manufacturers Association, an organization of 396 small business lumber manufacturers located in twelve southern states. Our member mills collectively produce nearly three billion board feet of lumber annually and all are independently owned and operated. Approximately 45 percent of our members are in close proximity of a national forest and are dependent, to various degrees, upon the sale of national forest timber for the raw materials needed to operate their manufacturing facility.

With me today is Burton Hankins, who is President and owner of Hankins Lumber Company in Grenada, Mississippi and Bob Davis, who serves as Forester for the Southeastern Lumber Manufacturers Association. Together, we will be pleased to answer any questions at the end of this presentation.

BACKGROUND:

In June of 1981, many of us in the forest products industry in the South believed that the lumber industry was not yet on the way to recovery, and operated under that assumption. We continued to purchase timber sales, and some were purchased at a higher price than we would have liked. I do not know of any SLMA member that will go out of business if relief measures are not passed. Keep in mind that many of the mills who purchase national forest timber in Region 8 are as dependent on Forest Service timber as are mills in the Northwest.

Two extension policy relaxations were granted by the Forest Service because of the very dramatic downturn in the housing market. The first extension was given in April, 1980, and the second was granted in October of 1981.

During September, 1981, the first talk of contract relief for the Pacific Northwest was heard in the South. Price roll-back, termination without paying damages, and contract term adjustments were new terms with unclear meaning. By November, two bills had been introduced into the House: The Renewable Resources Emergency Act of 1981 and The Emergency Timber Sale Act of 1981. Both bills were very similar and allowed the termination of any timber

contracts within a short period after enactment. To our knowledge no action was taken.

The next three to four months the industry spent most of its time working on a number of proposed Forest Service contract changes. Speculative bidding was the main reason cited for these changes. It was not until April 15, 1982 that the final changes were published. The lumber market was still unchanged.

During the latter part of April, 1982, the industry met in San Francisco, California to review contract relief proposals formulated by Northwest timber purchasers. Concepts were presented at this meeting, some which I believed the southern industry would have supported and some I was sure they would not. Two weeks later a delegation from the Pacific Northwest came to Atlanta, Georgia to explain the necessity of contract relief to the southern industry and what form this relief should take. May and June saw many meetings, compromises, additions, and more compromises. A proposed industry bill was drafted and an effort was made to include all of these additions and compromises.

The industry met again in July to review this draft legislation. This meeting was followed by more meetings which included proposals, counter proposals, and more compromises. That brings us up-to-date.

The Southeastern Lumber Manufacturers Association is opposed to S. 2805. We believe this bill is too general and does not give the necessary limits to the authority which can be taken by the Secretaries.

Furthermore, we do not believe that any legislation providing for termination, term adjustments, or price modifications in timber sale contracts can be made equitable for purchasers in all regions. Moreover, if a simple solution cannot be derived that would be in the best interest of the industry and the federal government we believe that nothing should be done. If legislation is forthcoming the SLMA would request that the Committee consider the following comments and recommendations.

RECOMMENDATIONS:

1. We believe that anyone in the forest products industry should have been aware of the downturn in our markets, at the very latest, by June, 1981. As noted previously, contract relief legislation was being considered in November, 1981. For these reasons, we believe it would be unethical to grant relief measures on timber sales purchased after October 1, 1981.
2. Section 2 of S. 2805 reads, "Upon a showing of economic hardship by the private contracting party,..." If legislation is forthcoming, we believe that economic hardship must be shown.

Guidelines should be incorporated in the legislation defining how hardship is to be determined.

3. The SLMA believes that no more than 25% of the volume held under contract as of October 1, 1981, should be considered for termination. The only exception should be if a purchaser desires to terminate one contract. One contract could be terminated no matter what the percentage of volume under contract. This would allow a purchaser with a large volume and many contracts to decide which of those, up to 25% of the volume, would best serve his firm if terminated. The purchaser who has only two or three contracts of which any one would equal more than the 25% limit would not be penalized. He could terminate one contract.
4. A purchaser who elects to terminate a contract should be liable for the total cost of reselling that contract. Furthermore, he should not be allowed to repurchase the timber in the contract he elected to terminate.
5. The SLMA believes that no more than 25% of the volume held under contract as of October 1, 1981, should be considered for contract term adjustment. Again, the exception should be to allow for a term adjustment on one contract.
6. Currently, the lumber manufacturers in the South are suffering from the importation of Canadian lumber. Which is being produced by an industry subsidized by the Canadian government. With very few exceptions, 30% of the lumber being sold in every southern state is from Canada. Markets normally enjoyed by manufacturers of southern pine in Delaware, Vermont, Pennsylvania, West Virginia, and other states are having over 75% of their lumber needs supplied by Canadian manufacturers. I point out these facts only to illustrate that the southern manufacturer cannot endure additional competition from regions benefiting from legislation as being proposed here today. The Pacific Northwest, Forest Service Region 6, is the area which will benefit the most from any forthcoming legislation. Because of this we request that any forthcoming legislation contain provisions which would provide for:

   (a) A reduction of the Forest Service timber sale program in Region 6 for the next two years. During the industry discussions a proposal was made to place a "cap" on U. S. Forest Service sales in Region 6 of 4.1 billion board feet in the 1983 and 1984 program year. Also included was a clause that allowed the Secretary to revert to a normal sale program if housing starts reached or exceeded 1.6 million units on an annualized basis for three consecutive months.

   (b) The purchaser of any contract granted a term adjustment

would be required to systematically operate all contracts bid prior to October 1, 1981.

The intent of these provisions is to reduce the large volume under contract while at the same time not allowing the already depressed lumber market to become flooded with unneeded lumber.

7. Purchaser credit was an item discussed by the industry. In reading the report prepared by Robert E. Wolf, Assistant Chief of the Environment and Natural Resources Policy Division of the Library of Congress, we find an interesting point made concerning purchaser credit.

> "Timber contract termination for high bid sales is not a strong factor in areas where 'ineffective' purchaser road credit prevails; thus, the two legs of the proposal (the industry proposal) are to fashion something attractive to areas where termination would not be of significant value."

Wolfe states later in the report, "The proposal to make 'ineffective' purchaser credit for road construction a guaranteed subsidy for timber is totally irrelevant to the issue of the alleged current conditions of the industry." (underline added)

The industry proposal allowed for several changes in the purchaser credit policy. In addition to making "ineffective" purchaser credit "effective" it allowed the transfer of purchaser credit between national forests. To allow the transfer of purchaser credit between national forests gives those firms that operate in more than one forest a more favorable cash flow over those firms who operate in only one forest. Changing the definition of ineffective purchaser credit would give multi-forest firms an even greater cash flow advantage over single-forest firms, and reduce the amount of revenues received by the federal government for timber sales. The SLMA has and must remain against changing the current purchaser credit policy. We cannot support any legislation which would allow these changes.

CONCLUSION:

The Southeastern Lumber Manufacturers Association believes that any legislation of this nature cannot be made equitable to all regions. Only by including provisions which will reduce the competitive advantages in other markets can some of the inequities be reduced.

Any provision that does not speak to a one-time relief package should not be included in any contract relief legislation.

I thank you for the opportunity to present our views, and I will be glad to answer any questions you may have.

A Statement By

Rexford A. Resler
Executive Vice President
The American Forestry Association

I am Rexford A. Resler, Executive Vice President of The American Forestry Association. The American Forestry Association is a national citizens' conservation organization formed in 1875.

We appreciate the opportunity to testify on legislation which would modify certain contractual conditions between the Secretaries of Agriculture and Interior and purchasers of federal timber. Two bills, to my knowledge, S.2805 and S.2818, have been introduced thus far in the Senate which would provide differing forms of relief.

First, I wish to address the unique situation which prompts these and other proposals for legislative relief.

My instincts lead me to believe that contracts entered between buyer and seller--in this case, purchasers of federal timber and the federal government--should not be subjected to tampering in mid-course. Changes of conditions which were understood at the time of sale invariably lead to inequities among parties who were competing under well-established rules. Those rules should not be changed, whether by legislation or exercise of Administration authority, without due regard to the consequences of disrupting a highly competitive market or for the inequities such changes may create among participants. These hearings, and others, will no doubt serve to identify those adverse consequences.

Be that as it may, we believe that there are extenuating circumstances which justify intervention to moderate the dire effects occasioned by economic conditions which few people, if any, could have predicted two to three years ago.

The record is all too clear of excessive unemployment in home building and in the forest products industry; of wide scale mill closures; increasing rates of bankruptcy; and the very real prospects of still greater business collapse, particularly among the independent operators. In my 30 years as a forestry professional, I have never encountered the degree of concern, even outright fear, about the immediate future that I find today among independent operators and major corporations alike. While one might argue that those who bid excessively to secure federal timber should now suffer the consequences of their decisions, I would argue that the government was an unwitting partner and in good measure responsible for the circumstances which brought on a major depression in the forest products industry.

One of those factors was uncertainty of supply of raw material. Successive Administrations have considered investments in forest productivity on the federal lands as an expense, not a long-term capital investment. As a result, investments that would produce ever-expanding supplies of federal timber, with full attention to realistic environmental safeguards, has been slighted consistently in Administration budget requests. Much of what has been achieved is the result of Congressional action to rectify the shortcomings of Presidential budget requests. Even so, the National Forest System has been offering timber sales for the past decade below the sustained yield capacity by 10 to 15 percent. And if the proper investments had been made to increase growth, those sustained yield harvest levels could have been steadily increasing.

Add to that reality uncertainty about the availability of federal lands for timber production and other commodity uses, caused by legal and political hassles over the disposition of roadless areas, and one commences to see why competitive bidding got out of hand. I believe Congress must accept a share of responsibility for its reluctance to bite the bullet--to decide what ought to be in the Wilderness System and what ought to be managed for non-wilderness purposes. Only Congress can resolve those issues.

A decade or more of rising inflation built in an expectation that purchasers of federal timber would be able to recoup on the desperation

bids they were submitting. Many gambled on the continued effects of an inflationary spiral and lost.

We have experienced major changes in the rules guiding thrift institutions which has affected the availability and cost of mortgage money. Estimates of annual housing starts for the decade of the 1980's in the range of 2-plus million, projected by both government and private sources, became conventional wisdom and influenced the attitudes and judgments of producers, investors, and market competitors.

As interest rates ballooned to the 20 percent prime rate, and as mortgage money shrunk, housing markets plummeted at unprecedented rates, drying up not only the housing industry but causing a major decline in markets for building materials. The drop in inflation, an event most urgently sought by us all, has exacerbated the serious problems faced by the entire forest products industry. The most serious problems, however, are associated with the federal timber sale contracts in the Pacific Northwest, many of which are economically inoperable under current market conditions, or conditions which may be realistically expected in the next two or three years.

If no action is taken to relieve the current situation, there will be survivors, of course, but I would expect to see a serious decline in mill capacity which would adversely affect consumer prices when the economy recovers and the pent-up demand for housing is released. I would expect to see a substantial consolidation of that production capacity in the hands of fewer large corporations. The high cost of capital will no doubt result in more consolidations over time, but that trend ought not be accelerated by government actions.

Because government policies and actions, or inaction as the case may be, are partly at fault--and because it is in our general interest to maintain a viable and competitive forest products industry--we conclude that some form of government action is not only warranted, it is urgently needed.

The several legislative remedies under consideration in these hearings should provide a basis for positive action. I am persuaded that prompt Congressional action is needed to relieve an untenable situation. Without the Administration's support, nothing of value will be accomplished in a timely manner. I hope that a workable compromise can be struck with the White House that will provide prompt relief.

I wish to comment on some of the remedies being proposed.

Further liberalization of extension policy permissible under the contracts is not likely to help. It will not put people back to work or ease the economic circumstances of timber-dependent communities. It will simply put off the problem a bit longer. Furthermore, by delaying action on extended sales, the orderly development of future sale offerings dependent on access roads to be constructed on extended sales would, of course, be disrupted and delayed. In time, such extended sales could conceivably be operated, but that is a slim reed for a drowning operator.

Price roll-backs, while attractive on the surface and would help those who have contracts, create serious inequities among competitors in the market place. We believe this option to be grossly unfair.

Contract term adjustments going beyond those permitted under the contract requires legislation. Such adjustments have the same drawbacks as contract extensions, that is, putting off the problem until some future time and disrupting orderly development of future offerings. However, term adjustments for periods up to 5 years would permit purchasers to mix high-priced sales with newer and presumably lower priced federal sales, or timber from other sources including fee timber, thereby permitting purchasers to operate those adjusted sales when market conditions improve. So we support the logic of authorizing contract term adjustments under carefully prescribed conditions.

Contract terminations without penalty is a drastic step used only once previously to my knowledge. We came to the conclusion, reluctantly,

that contract terminations without penalty are warranted by current dire circumstances. The alternatives of (1) extensions of time, or (2) damage settlements on expired contracts, will not solve the immediate problem. It is our judgment that some portion of economically inoperable sales should be terminated as the most effective means for: (1) getting inoperable sales back on the market at operable prices; (2) salvaging the investment of the agencies in sales preparation work; (3) avoiding the high cost of damage appraisals and litigation and delay that would be incurred; (4) reducing the prospects of bankruptcies or takeover of independent operators; and (5) hastening the time when out-of-work people in the woods, mills, and dependent communities can be put back to work.

One can argue that the federal treasury would lose income as a result of foregoing damages on terminated sales. The likelihood is that most of the assessed damages would never be recovered anyway. Lengthy litigation would forestall collection under the "best of circumstances" and little is to be gained through bankruptcy settlements. The cost to the federal government of trying to collect those damages, the consequent effects on the general economy, and eventually on the consumer, leads me to believe that the apparent loss isn't worth the chips.

We favor writing off the loss, under carefully defined rules of law, for some appropriate portion of inoperable sales. The conditions should be prescribed in law as opposed to authorizing the Secretaries of Agriculture and Interior to define those rules. If, as we believe, this remedy is warranted as a matter of public policy, then those conditions ought to be defined in law.

We believe that such terminated sales should be metered back on the market as a part of the agencies regular sales program in ways and amounts that do not change or adversely affect markets in other parts of the country. If, as these terminated sales are brought back on the market, the Administration will support the advance preparation of new sales, it would be possible to expand the volume of timber prepared and held "on the shelf" so that for the first time in my recollection, the agencies could respond to surges in demand.

On a related matter of cash flow, discussion has centered around the need for treating earned purchaser road credits as cash, or at least, authorizing the transfer of earned credits among sales on different National Forests. We do not favor treating earned road credits as cash whereby credits could be transferred to cover any cash obligation, but we do support the logic that earned credits be transferred to any sale being operated by purchaser to permit recovery of those front end costs. Considering the high interest rates everyone is facing, it makes sense to authorize a means that would permit more rapid recovery of earned road credits. After all, the consumer eventually winds up paying the cost of inoperative capital.

Mr. Chairman, we have reluctantly come to a conclusion to recommend intervention in a free market system. We believe that legislation along the general lines we have discussed, the details of which should emerge from these deliberations, should be tightly drawn, limited in time, and at the earliest possible time, this ailing free enterprise system should be put back on its feet and the legislative "remedies" terminated.

We appreciate the opportunity to comment on this highly complex and controversial situation. We will be pleased to assist in any way we can to find an equitable solution.

STATEMENT BY HARRY WILLIAMS, PRESIDENT
SOUTHERN FOREST PRODUCTS ASSOCIATION

I am Harry Williams, president of the Southern Forest Products Association, whose headquarters are in New Orleans, Louisiana. I am also President of Williams Forest Products Corportion, Cleveland, Texas. We are very grateful for the opportunity to testify at these hearings and I want to congratulate Senator Hatfield for wanting to do something constructive about a very bad situation.

The member companies of our Association have operations in Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North and South Carolina, Oklahoma, Tennessee, Texas and Virginia. Their mills account for almost three-fourths of the total Southern Pine lumber production. Our members have been gravely hurt by the collapse of the housing market which has plunged our industry into its worse crisis since the Great Depression of the 1930s. Southern Pine lumber production and shipments have been running 30 percent below normal and the unemployment rate at our member mills has risen above one-third.

We are aware, of course, that our plight in the marketplace is shared by Western lumbermen. We also know their problem has been aggravated by the very large amounts of National Forest timber contracted for in the late 1970s at higher prices than you can sell lumber for today. We feel that massive defaults on these contracts by Western operators would not only be catastrophic for the timber economy of that region but also for us, since under current Forest Service policy the defaulted timber would have to be placed back on the market in amounts far exceeding current demand levels. The resulting "glut" of the marketplace with Western National Forest timber at extremely low prices could be disastrous for Southern lumbermen who get most of their raw material from privately owned lands. Not only would this competition force down the prices of private timber--to the great detriment of the South's two and one-half million nonindustrial private forestland owners--but would also adversely affect the stock values of timber companies owning forestland in our region.

So it is with an instinct for self preservation as well as our desire for recovery of the timber economy in all producing regions that we look with sympathy on the quest of the western operators for legislative relief from their contractual problems.

However, we cannot support efforts to provide for the comfortable recovery for our Western friends at the expense of the industry and jobs so vital to our region. We are aware that with more than one-third of our member mills closed down we can ill afford any further contractions of an already depressed lumber market. Therefore, we are determined that in our efforts to help solve the Western contractual problem, we do nothing that will compromise our own situation.

Evidence indicates that lower stumpage prices for National Forest timber in the West have made it possible for that region to capture a larger share of our backyard lumber market, in spite of substantially higher transportation costs.

The Western Wood Products Association reports that in the first six months of 1982 the South took a larger share of lumber from Western sawmills than at any time since 1970. This is not difficult to comprehend when one considers some of the advantages Western operators have even under present market conditions.

A comparison of minimum bids and average successful bids between Forest Service Region 6 in the Northwest and Reigon 8 Forest Service in the South is significant. In 1980, Region 8 had an average advertized minimum bid of 139.56 compared to 87.02 in Region 6.

Successful bid prices that year in Region 8 averaged 195.89 whereas in Region 6 they averaged 306.84. The figures for Region 6 are averages of East and West side prices, which are substantially lower in the East.

From these 1980 figures, it seems obvious that in relatively good times the cost of successful bids in the West prices their product out of the South. But then they don't need to because they can sell their production at home.

But lets compare some more recent statistics. In June 1982 the average minimum bid for Region 6 timber was $41.72, less than one-half the average of 1980. Sucessful bid averages were $79.58 only one-fourth of the average price in 1980.

In Region 8, quite the opposite was true. In June 1982, the average bid price was $134.22, only 5 dollars less than in 1980.

Successful bids averaged $149.77, more than 3/4's the 1980 price and $70.19 more than that for National Forest timber in the West. With that differential its small wonder that more Western lumber has found its way south. Our problem is aggravated by the Canadian Government's subsidization of their industry but that is another matter.

There are other advantages that Western operators have such as log scaling which does not exist in the South, a different bidding procedure, more advantageous Forest Service Contracts, requirements to put less money down and more.

We, therefore, are considering some agreement which will allow survival of the Western industry without unnecessarily imperiling the survival of our own. With respect to this, the chronology of our involvement with the issue is illuminating.

On January 28 of this year, our Executive Committee adopted a resolution approving extensions of Federal timber contracts but opposing terminations and rollbacks. Then, as the magnitude of the crisis in the West became increasingly obvious, our position changed. At our midyear meeting in early June, we voted to rescind the earlier resolution on termination and to actively support relief legislation, provided that it contain certain stipulations and provisos.

Since the June meeting, our officers and executive committee have struggled daily to find a solution that would meet industrywide acceptance. We have negotiated with the Western operators. We have met with Assistant Secretary of Agriculture John Crowell on several occasions. And the Association officers have spent innumerable hours on long distance conference calls.

The results of a July 16 written poll of the members of our executive committee indicated their support for relief legislation provided that it include a cap on Forest Service sales in Region Six plus other safeguards. The cap we propose is 4.1 billion board feet annually in Fiscal Years 1983 & '84. Also, we would approve an escape clause providing that if the Secretary of Agriculture determines that the demand for forest products increases, as indicated by housing starts, on an annualized basis to reach or exceed 1.6 million units for three consecutive months, the Secretary shall revert to a normal sales program.

Additionally we can support no legislation allowing greater than 40% termination of a federal timber contract. Wholesale termination would grant sanctuary to speculators and encourge such operations at the expense of legitimate timber interests. It was no doubt speculation to some large extent which bid up the price of Western timber to such dizzying heights in the late 1970's.

Termination and caps notwithstanding, we feel that the most acceptable and least controversial manner in which to solve the timber sales crises is addressed in S. 2818, by Senator McClure. This bill would authorize the Secretaries of Agriculture and Interior to adjust the termination dates of any contract entered into before January 1, 1982 for up to five years without penalty. Such an contract term adjustment would provide time and allow for markets to return to more reasonable levels. It would allow operators to mix new and old sales thereby allowing them an opportunity to achieve a realistic price structure without complete reliance on timber that can't be manufactured and sold at a profit in today's depressed market. Contract term adjustment would also require some accountability from those who bid and thereby bound themselves, a better lesson than that which would be taught by wholesale termination. Contract term adjustment would also delay but not reduce greatly the large sums due the federal government for these Forest Service sales.

Forest Service statistics indicate that unless a cap is imposed on Region Six sales, the problem we are here to address today will not be solved but further aggravated. In 1981, the volume of National Forest timber under contract but not harvested exceeded 32 billion board feet, of which more than 16 billion feet--or about one-half--was in Region Six. The total estimated for 1982 is over 33 billion feet.

Just why this unharvested backlog is so huge is evident from other figures for Region Six. In 1979, slightly more than five billion board feet were sold in the region and about four and one-half billion feet were harvested. But, thereafter, the divergency grows. For 1980, the totals were slightly more than five billion feet in sales and three and a half billion feet in harvests. In 1981, there were five and half billion feet in sales and only three billion feet in harvests. In 1982, the gap is believed to be even wider.

From such statistics, it's obvious that without a cap on Region Six sales and maximum of 40% termination, as we propose, the volume of sold but unharvested National Forest timber will continue to accumulate in a manner not unlike the growth of the Federal deficit. And since, the Forest Service is seeking five point four billion feet of Region Six sales for 1983 and 5.8 billion feet in 1984, the danger of a market glut from the termination of unharvested sales grows appreciably.

In addition to our insistence on a cap and 40% maximum on terminations which would eliminate the danger of a market glut in a period of low demand, we are also extremely concerned about proposals that purchasers' credits for road building and other work in connection with National Forest timber sales be allowed to be shifted from one National Forest Region to another. We fear that could open a can of worms. For example, an operator with contracts in Region Six but who also has operations in the South, might be able to shift his credit from the West to a National Forest in Region Eight and get his Southern timber, in effect, without further investment.

We would prefer that transfer of credits be limited to the region and National Forest of origin and to sales made prior to January 1, 1982.

We also believe that any relief legislation should provide some mechanism whereby terminated and/or defaulted timber is returned to the market in an orderly fashion and in amounts that will not increase the levels of the existing sales program in a depressed market. While we will support up to 40% terminations if proper safeguards are included in the legislation, we also are convinced that some performance on the part of the operator should be required on his remaining contracts.

Since Senator Hatfield's bill does not contain a Region Six sales cap or other safeguards we have proposed, we cannot support the bill in its present form. We have also noted that the language of the bill provides for price modifications. While we have rescinded our original opposition to terminations, we remained unalterably opposed to price rollbacks because of the loss of money that would involve for the Federal government at a time when fiscal responsibility is all important, and because it would be unfair to other lumber producers not benefitting from the rollbacks. Moreover, there are disparities in sales contracts between Forest Service regions which should be addressed by the legislation. Southern operators bid under a "transaction evidence" appraisal system that does not respond favorably in falling markets. The more responsive "residual value" system used in the West has resulted in lower timber prices in the West than those other producers must pay in the South.

I sincerely hope these problems can be worked out in the course of developing the legislation in a way that will create genuine consensus within the Congress, the Administration and the industry as to what will best serve the public interest in this urgent matter.

98-286 O - 82 - 7

TESTIMONY OF
PAUL K. EHINGER
EXECUTIVE VICE PRESIDENT
WESTERN RESOURCE ALLIANCE
EUGENE, OREGON

The forest products industry nationwide is in the longest and deepest collapse that it has experienced since the Great Depression of the 1930's. It has lasted so far for approximately 2½ years. No apparent relief is in sight. The markets for our products continue to erode both in price and volume on a weekly basis. The current economic climate may be a recession in general, but for the forest products industry it is a true depression.

The companies in the West that depend on public timber have been particularly hard hit.

The demand for wood products was high in the late 1970's. At the same time and as late as the spring of 1981,, all the economists, both government and private, predicted that the decade of the 80's would be a period of continuing high demand for housing and the products of the timber industry. In other words, they predicted, and so we expected, a continuation of the 70's in both demand and price. It was in this climate of economic forecasting and the threat of potential timber shortages that the operator dependent on public timber competed for his future raw material in the late 1970's and through the start of the 1980's. He was forced to bid for the available timber which was to be his supply over the next two to seven years.

The result is that in the highly competitive areas of the west, 90 per cent of the timber under contract from the Forest Service and Bureau of Land Management now is held at prices which, if paid, would be financial suicide for the operator.

Under current markets, the annual loss to the average operator if forced to harvest this timber would far exceed the asset value of the mill which manufactured the log into plywood or lumber.

The operators dependent on public timber and their

communities are literally fighting for survival with the albatross of these impossible-to-operate timber sales around their collective necks.

The industry throughout the nation has worked diligently to find a solution to the problem that would give some measure of relief where needed while not transferring the problem from one region to another. It was in this spirit that the attached legislative proposal was developed. There is support from a major portion of the industry for this proposed bill. While we have differences between the South and West concerning the specific details of the approach to the Forest Service timber sale program for fiscal years 1983 and 1984, we are in agreement that the sales which would be terminated under this proposal should be reoffered as part of, not in addition to, the regular timber sale program. We do not want to open the possibility of depressing markets and values in other regions of the country.

The basic elements of the industry proposal are as follows:

1. Entitle a contract holder to terminate approximately 40 per cent of his volume under contract, with small operators having the option of completely terminating 15 million board feet or any one contract.

2. Entitle a contract holder to extend the termination date of the balance of his contracts for five additional years, with specific performance requirements during the final years of the extension.

3. Require the payment of three dollars per thousand board feet of terminated timber to cover the costs of reselling that timber. This figure is based on Forest Service estimates of resale costs.

4. Require completion of roads on terminated or extended sales as determined appropriate by the administering agency; this will assist in creating jobs at an early date independent of timber market forces, and will assure that access to other timber sales is not blocked.

5. Compensate all purchasers equally for construction of permanent roads for the Forest Service by making all purchaser road credits effective, usable in any National Forest, and transferable to another purchaser.

There are other details of the proposal which are embodied in the draft bill which I submit formally to the committee.

I want particularly to emphasize that the termination and extensions proposal is one with no cost to the government. Our plan also contains certain immediate employment opportunities, and offers an opportunity of survival to dozens of independent operators who are primarily dependent on federal agencies for their basic source of timber.

A BILL

To provide for the orderly termination or extension of certain contracts for the sale of federal timber, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress Assembled,

Sec. 1. The Secretary of Agriculture for National Forest System lands and the Secretary of the Interior for public lands are authorized to--

(a) terminate contracts for the purchase of timber which were bid prior to January 1, 1982, and for which the conditions in section 2 are met; and

(b) to extend contracts under the conditions stated in section 3.

Sec. 2. (a) (1) A purchaser may terminate a contract pursuant to this Act if the purchaser--

(A) files a written request for termination within 45 days following the concurrent publication of procedures by the Secretaries pursuant to Section 6, specifically identifyin each contract for which termination is requested;

(B) agrees to pay the Secretary holding the contract, within 30 days of billing, a sum equal to $3 per 1,000 board feet or equivalent measure for the costs which will be incurred by such Secretary in terminating such contracts and for reoffering the timber terminated for resale, and

(C) agrees to release any claim against the United States arising out of or connected with each contract to be terminated.

(D) If a request for termination made pursuant to clause (A) is denied, a written request for alternative contracts may be filed within fifteen days of receipt of notice of denial.

(E) Payment made pursuant to clause (B) shall be in lieu of any damages, penalties, or claims that such Secretary might otherwise assess.

(2) Contracts to be terminated pursuant to this Act under which no harvest has taken place shall be terminated in full. Contracts to be terminated pursuant to this Act under which harvest has begun, shall be terminated conditionally with the termination becoming final after the purchaser has completed all contractual obligations for the units or a logical portion of a unit on which harvest had begun as determined by the Secretary. All remaining unharvested units covered by contracts also covering such partially harvested units must be terminated. The Secretary need not terminate a contract if he determines that the remaining unharvested units are not representative of all units that were to be harvested on the contract area in terms of species and logging methods.

(3) The Secretary may, in his sole discretion, require the completion of any roads specified in a contract to be terminated and the decking of right-of-way timber.

(4) Purchaser shall be current in all payments and not be in default on a contract at the time of its termination pursuant to this Act.

(5) (A) The volume of timber in contracts to be terminated shall not exceed 40 per centum of the estimated timber volume specified in the purchaser's contracts bid as of April 1, 1982 for timber from National Forest System land and public lands less any volumes cut, removed, and paid for.

(B) In addition to the contracts meeting the condition of subparagraph (A), one contract which was bid prior to January 1, 1982 but after the date of bid of all other contracts to be terminated may be terminated.

(C) The estimated timber volume terminated under subparagraphs (A) and (B) shall not exceed by more than 10,000,000 board feet (or equivalent measure) the 40 per centum limit imposed by subparagraph (A).

(D) Purchasers may, in lieu of the 40 per centum limitation specified in subparagraph (A), terminate contracts having an aggregate volume of up to 15,000,000 board feet or terminate one contract.

(b) (1) For each contract meeting the conditions in subsection (a) the Secretary shall set-off cash deposits, and purchaser credit or the timber sale appraisal allowance for the value of completed roads against the amount payable to the applicable Secretary under subsection (a) (1) (B), applying the cash deposits before the purchaser credit or the timber sale appraisal allowance for the completed roads in the

set-off. The Secretary shall provide each purchaser with a statement of account which shall provide an accounting of any set-offs made pursuant to the preceding sentence.

(2) Any cash deposits that exceed the amount payable to the respective Secretary under subsection (a) (1) (B) shall be refunded to the purchaser within 60 days after the termination.

(3 Purchaser credit earned by purchasers of National Forest System timber and shown in the timber sale statement of account described in paragraph (1) that remain after set-off against amounts owed to the Secretary of Agriculture shall, at the purchaser's election--

(A) be transferred to other contracts with the Secretary of Agriculture held by the purchaser;

(B) be retained by the Secretary of Agriculture for future application by the purchaser to other contracts for the sale of National Forest System timber; or

(C) be assigned to another party with all rights attributable.

(4) The timber sale appraisal allowance for the values of completed roads made in connection with the sale of timber from public lands described in paragraph (1) that remain after set-off against amounts owed to the Secretary of the Interior may, at the purchaser's election--

(A) be transferred to other contracts with the Secretary of the Interior held by the purchaser;

(B) be retained by the Secretary of the Interior for future application by the purchaser to other contracts for the sale of timber from public lands; or

(C) be assigned to another party with all rights attributable.

(5) Purchaser shall be billed for any remaining portion of the amount payable to the Secretary after the set-off in paragraph (1), and purchaser must pay that amount prior to termination of the contract.

(c) A purchaser granted termination of a contract pursuant to this Act shall not, if otherwise eligible, be prevented on account of the termination from bidding on any resale of timber included in a terminated contract.

(d) (1) Timber included in any contract terminated by the Secretary of Agriculture under authority of this Act may be reoffered for sale without regard to the annual limitation imposed on costs of construction of forest roads by timber purchasers as specified in the fourth provision of the paragraph entitled "Construction and Land Acquisition" of title II of the Act entitled "An Act making appropriations for the Department of the Interior and related agencies for the fiscal year ending September 30, 1982, and for other

purposes", approved December 23, 1981 (Public Law 97-100; 95 Stat. 1405) or to such annual limitations as may be imposed in appropriation acts for fiscal years 1983, 1984, and 1985.

(2) All terminated and/or defaulted Forest Service timber shall be resold in an orderly fashion and be included in the total allowable sales in the fiscal year in which it is offered.

(e) Until the procedures authorized by this Act shall have been in effect for 45 days, no contract that is eligible for termination or extension under this Act shall terminate or be terminated, without the consent or request of the purchaser.

Sec. 3. (a) Termination dates of any contracts for the purchase of timber from National Forest System lands or public lands that were bid before January 1, 1982, shall, without penalty or any payment which may otherwise be required, be extended, at the written request of the purchaser, by the appropriate Secretary for 5 years from the termination date in effect on the date of enactment of this Act, except that the Secretary may require the purchaser requesting such extension to complete all or a portion of the road construction set forth in the contract by a date to be specified by the Secretary.

(b) Any contract with the termination date adjusted under this section shall require--

(1) removal of 25 per centum of the estimated timber volume by the conclusion of the third operating season of the additional period provided by the adjusted termination date; or

(2) payment by the purchaser of 25 per centum of the contract price, including all payments to date under the contract, by the start of the fourth operating season of the additional period provided by the adjusted termination date.

(c) A contract shall not be available for extension under subsection (a) if it involves substantial amounts of timber subject to rapid deterioration except with approval of the appropriate secretary.

(d) On National Forests west of the summit on the Cascade Range of Forest Service Region 6, the transfer of purchaser credits during a contract term adjustment period provided by this section for roads on which construction was not begun prior to the date of enactment of this Act will be limited to transfer to sales purchased prior to the date of enactment of this Act.

Sec. 4. (a) Notwithstanding any other provision of law, amounts paid to and retained by the Secretary of Agriculture under the provisions of this Act shall be covered into the Treasury and shall constitute a special fund, which is hereby appropriated and made available for use by the Secretary of Agriculture in preparing, advertising, offering, and selling timber.

(b) Notwithstanding any other provision of law, the amounts paid to and retained by the Secretary of the Interior under the provisions of this Act shall be deposited in the Treasury to the credit of the appropriations then current and chargeable for the costs of preparing, advertising, offering, and selling timber.

Sec. 5. The last sentence of Section 4 of the Act entitled "An Act to enable the Secretary of Agriculture to construct and maintain an adequate system of roads and trails for the national forests, and for other purposes", approved October 13, 1964 (78 Stat. 1089; 16 U.S.C. 535) is amended by--

(a) striking out "authorized" and inserting in lieu thereof "directed";

(b) striking out "effective";

(c) inserting after "1975" the following: "under a contract not completed by the date of enactment of this Act"

(d) inserting after "same" the following: "or different"; and

(e) striking out all after "purchaser" the third time it appears to the end of the sentence and inserting in lieu thereof: "; where a purchaser exercises an available option to have the Forest Service construct a road, provisions for transfer of any available credit similar to that provided above in this sentence will be made using the engineer's estimated cost of construction in lieu of the agency's estimated cost of purchaser construction."

Sec. 6. The Secretaries shall publish procedures which have the effect of law implementing the provisions of this Act within 30 days after the date of enactment of this Act.

LAW OFFICES OF
PRESTON, THORGRIMSON, ELLIS & HOLMAN
SUITE 500
1776 G STREET N. W.
WASHINGTON, D. C. 20006
AREA CODE 202-628-1700
TELECOPY 202-331-1024

RICHARD L. BARNES
WASHINGTON, D.C.

SEATTLE, WASHINGTON OFFICE
2000 I. B. M. BUILDING
SEATTLE, WASHINGTON 98101
AREA CODE 206-623-7580
TELEX 328428 (THORSEA)
TELECOPY 206-623-7022

ANCHORAGE, ALASKA OFFICE
SUITE 404
420 L STREET
ANCHORAGE, ALASKA 99501
AREA CODE 907-276-1969

August 16, 1982

Honorable S. I. Hayakawa
Chairman, Subcommittee on Forestry,
Water Resources & Environment
322 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Hayakawa:

Enclosed is a "Statement in Support of a Timber Industry Proposal for Modification of Federal Timber Sale Contracts" which has been endorsed by seven timber industry associations, but which was not completed in time for your very excellent hearing of last Thursday, August 12.

We request, however, that the Statement be inserted in the hearing record, along with the written statements submitted at the hearing by Paul F. Ehinger of Western Resource Alliance.

Thank you very much.

Sincerely,

PRESTON, THORGRIMSON,
ELLIS & HOLMAN

By Richard L. Barnes
Richard L. Barnes
Counsel for
Western Resource Alliance

RLB:pd

Enclosure

STATEMENT IN SUPPORT OF A TIMBER INDUSTRY PROPOSAL
FOR MODIFICATION OF FEDERAL TIMBER SALE CONTRACTS

Submitted By:

INDUSTRIAL FORESTRY ASSOCIATION, Portland, Oregon

NORTHWEST INDEPENDENT FOREST MANUFACTURERS, Tacoma Washington

NORTHWEST PINE ASSOCIATION, Spokane, Washington

NORTH WEST TIMBER ASSOCIATION, Eugene, Oregon

WESTERN FOREST INDUSTRIES ASSOCIATION, Portland, Oregon

WESTERN RESOURCE ALLIANCE, Eugene, Oregon

WESTERN TIMBER ASSOCIATION, San Francisco, California

I. Most of the Timber Industry has Formulated a Proposal to Deal with an Important Federal Aspect of the Present Industry Depression.

The timber industry is beset by a worsening depression. Industry associations and companies began considering nearly a year ago whether federal legislation would be both necessary and feasible to alleviate the distress being suffered by many communities, workers and companies. Despite differing perspectives based on such factors as geography, company size and past business practices, most members of the industry have gradually coalesced in the past months in support of a compromise plan. This proposed legislation is designed to save federal expenditures, reserve regional, community and company stability, and avoid a windfall for any particular industry segment.

Not every element of industry is in complete agreement on every point of this proposal. But it is the proposal with by far the greatest support of the largest portion of the industry.

This statement will discuss in detail the condition of the industry and need for legislation, the financial advantages to government of enacting this plan as opposed to taking no action, the evolution of industry near-consensus, and the specific details of the industry proposal as well as views on specific elements of legislation proposed by others.

II. The Timber Industry Depression has Created an Urgent Need for Federal Action to Adapt to New Economic Ground Rules.

A. Industry's Market has Collapsed as a Result of the Plunge in Housing Starts.

The timber industry is in a state of depression caused by broader economic factors beyond the control of the industry. Policies of the Federal Reserve Board aimed at curbing inflation resulted in high interest rates generally and record high home mortgage interest rates in particular. These high mortgage rates, together with other unfavorable general economic developments, have plunged housing starts to their lowest rate since World War II. Because housing is the largest single user of lumber and plywood, the timber industry that produces lumber and plywood has followed housing into collapse.

According to the U.S. Forest Service, softwood lumber production has fallen from 31.3 billion board feet in 1978 to 23.6 billion board feet in 1981. Softwood plywood production has fallen from 19.5 billion square feet to 16.1 billion square feet during the same period. Production has continued to decline during the first half of 1982.

B. Industry Production has Fallen Sharply, Causing Mill Closings and Curtailments, and Severe Unemployment and Short Work Weeks.

For a variety of reasons including bulk and high carrying costs lumber and plywood are not inventoried for long periods of time by their producers. Drops in production directly reflect loss of market rather than inventory manipulations.

As a result of production declines, mill closings and curtailments have soared during the past two years, and employment has declined markedly. According to the Western Wood Products Association, between 32,000 and 64,000 of the 102,000 employees in 756 western sawmills have typically been on layoff or reduced work weeks during most weeks of 1982. Between 265 and 428 of those mills have typically been closed or on curtailed operations. According to the American Plywood Association, between 5,000 and 6,100 of the 21,000 employees in 110 western plywood mills have typically been on layoff or reduced work deeks during most weeks of 1982. Between 50 and 65 of those mills have typically been closed or on curtailed operations. Assuming a typical ratio of two indirect jobs for each direct job, that means some 210,000 jobs in the west alone are affected by the industry's depression.

C. The Loss of Market has Pushed Prices Down by as Much as Half in an Industry where Low Prices Do Not Generate Demand.

With the decline in markets for lumber and plywood has come a plunge in the price of these products. According to textbook economics, a drop in sales should lead to a lowering of prices which in turn will fuel new demand that restores sales levels. For lumber and plywood, however, price does not create demand. Rather, demand sets price. Historically, as demand and production increase, so does price, with little curtailment of demand. But as demand and production fall, so also does price, with essentially no creation of new demand. This scenario results because housing construction, which controls lumber and plywood demand, increases or decreases as a result of interest rates, not lumber and plywood prices. Although these prices have some significance in setting the price of a house, they play virtually no role in determining whether that house will be built or not.

Since their high points during 1979, prices for key lumber products have fallen by more than half. Unseasoned Douglas fir 2x4's, for example, an important product from western Oregon and western Washington, sold at $326 in August 1979, but are selling for $140 in August 1982, according to the trade publication Random Lengths. The basic western plywood product, Douglas fir 1/2" CDX, sells presently for $165, down from $235 in August 1979.

D. Costs of Much Raw Material, Established in a Different Economic Environment, Now Are Impossible to Meet as a Result of Plunging Prices for Finished Products.

Western Oregon and western Washington is the single largest source of lumber and plywood in the United States. Although large companies own significant timber acreage in that area, over

half of timber is publicly owned, with most of the public portion administered by the U.S. Forest Service. Most companies in the area are heavily dependent on Forest Service timber for their raw material, and many are dependent on one or another source of public timber for 100 per cent of their raw material. The large number of companies in the region breeds significant competition for this timber, which companies must have to remain in operation.

Forest Service timber is typically sold three to seven years ahead of the season during which it actually will be harvested and manufactured into lumber or plywood. During the late 1970s and into the start of the 1980s, companies bid for Forest Service timber in part based on their calculation of what products manufactured from the timber would be worth at the future time of harvest. Government and reputable private economists foresaw a continuation of high inflation, moderate mortgage interest rates, and the entry of the post-World War II baby boom generation into its prime home-buying years. These conclusions added up to a housing boom for the 1980's and high demand for lumber and plywood.

As a result, bids for National Forest timber rose spectacularly. For example, prices for Douglas fir, the principal species in western Oregon and western Washington, soared from $41.90 per thousand board feet in 1970 to $432.20 in 1980, more than a ten-fold increase. In addition to the economic forecasts for the 1980's, bidders were influenced by a feared future shortage of timber resulting from unresolved public policy decisions over how much federal land suitable for timber should be allocated to wilderness or other uses barring timber harvest.

The timber bid to high levels in that different economic climate now comprises much of the timber available for manufacture in the present period of low product prices. Because raw material can typically account for 60 per cent or more of the manufacturing cost in a western Oregon or western Washington mill, the price of much timber now is too high for it to be harvested and manufactured at anything short of catastropic economic loss. In numerous cases, the cost of the raw material alone is higher than the current market value of the finished products without even taking other costs of manufacture into account.

Various estimates by the Forest Service and industry analysts show that as much as 90 per cent of the present volume of timber under contract in western Oregon, western Washington and Northern California is economically unharvestable. In western Oregon, the average delivered pond cost (stumpage price, plus logging and delivery cost as appraised at time of bid) of timber under contract is $469, twice the average market value today for such logs. See Appendix A.

E. The Volume of Stumpage Too High-Priced to Harvest is Widely Distributed and Increasingly Critical as Deadlines for its Harvest Approach.

In western Oregon alone, 39 companies hold 50 million board feet or more of Forest Service timber under contract at average prices per company typically higher than $300 (not including logging or delivery costs). Appendix B lists specific data for this area.

As these contracts begin to approach their final year or two for performance, purchasers increasingly face the choice of whether to default the contract and risk owing a large money judgment, or harvest at a major loss. The Forest Service so far has

twice provided for extensions of contract expiration dates, though at some cost to purchasers. Although contracts allow for a no-cost adjustment of the termination date for such events as fire or Act of God, a major change in economic climate is not a qualifying event.

On May 7, 1982, the Forest Service relaxed its extension payment provisions, but still requires payment of interest on the unpaid purchase price of the timber as a condition of extension. For purchasers with reduced or non-existent cash flow, even the payment of interest may result in a decision to default a sale. The timing of contract expiration dates and extensions is such that these decisions will start to come with increasing frequency over the next few months.

F. Legislation is Necessary Now to Broaden the Array of Actions that can be Taken by Purchasers and the Government.

The timber industry is traditionally cyclical. Operators are used to weathering perhaps one bad year in five. But the present depression is unparalleled since the Great Depression of the 1930's, and is totally unparalleled in terms of the mammoth overhang of federal timber contracts that cannot be operated.

Revised economic forecasts for the rest of the decade, based now on recent government policy changes such as concerning inflation and structural changes in the savings industry, make it doubtful whether much of the high-priced timber now under contract can ever be economically harvested.

Clearly the ground rules of the game have changed so markedly that broader possibilities than mere extension of contracts must become available in order for the fundmental adjustment of the industry to these new rules to take place. A significant portion of these contracts should be terminated and the remainder extended without cost. Additionally, the Forest Service should more fully pay the cost of its roads. This proposal is discussed in detail below at Section V.

III. The Industry Proposal Would Save Money for the Government and Benefit Communities, Workers and the Public Interest.

A. The Choice Facing Congress is How to Make the Best of a Disastrous Situation, Not Whether to Preserve Illusory Benefits that In Fact Have Already Disappeared.

The timber industry has been accused by some of seeking a bailout from the federal government for companies that bet and lost. The industry plan, in fact, is not a bailout and is markedly different from relief proposals which have been adopted or discussed for other industries.

The principal money item at issue is the value of the timber under contract. Industry's plan has been portrayed by some as if a portion of the original contract value is being handed back to industry. In fact, the portion of that value which exceeds the present value of the timber has already been lost because of the supervening market forces discussed above. The timber under contract has a nominal value based on the contract prices bid up to several years ago, but that is far in excess of its real value. The difference in values has disappeared--it has not nor would not go to either the industry or the government.

The notion that the government can capture the original contract value simply by enforcing the contracts ignores the realities of the situation. More to the point is what the

government can do to minimize its loss and avoid sending good money after bad.

B. The Industry's Termination and Extension Proposal Would Not Cost the Government.

No grants, loans or loan guarantees typical of other relief programs are involved in the industry proposal.

The Office of Management and Budget detailed six major reasons why President Reagan vetoed in late June a bill characterized as a $3 billion bailout for the housing industry. These reasons included: (1) government spending cannot create new jobs, only reallocate existing employment; (2) the bill would create pressure for similar bills for other industries and worsen budget deficits; (3) adding to the budget deficit will aggravate interest rates; (4) new federal programs to channel credit to one segment of the economy will choke off activity elsewhere; (5) a reduced deficit is the best relief for housing; and (6) the housing package is a budget buster with unsupported estimates of its effect. None of these reasons is applicable to industry's termination and extension plan for the general reason that it doesn't call for federal spending.

C. The Government Would be Unable to Collect Damages from Massive Contract Defaults, and Would Trigger Other Adverse Impacts Even if it Tried to Collect.

The argument that the government should stand firm on high-priced timber contracts assumes that the government can recover the original contract price through a combination of resale and damages if the contracts are defaulted. A purchaser who defaults is liable to the government for the difference between the original sales price and the price upon resale of the contract if the latter price is lower. If the resale price is higher, then there are no damages. But in the present economic environment, resales of a contract defaulted for economic reasons would almost certainly bring a far lower price. For example, Douglas fir on the west side of Forest Service Region 6 presently is selling for less than one-fourth what it sold for early in 1980. See Appendix C.

In order to make its case for damages, however, the Forest Service would first have to reoffer the sale promptly and in an essentially identical fashion. Satisfying those two criteria could create other problems, however.

The prompt reoffering of numerous defaulted sales would tend to flood the market with more timber than it would want to absorb. That could force prices artificially low. Since most of the reofferings presumably would be in Region 6, site of the highest-priced existing contracts, there would be potential for regional market dislocation by products produced from such artifically low-priced timber. The Forest Service already has said it would reoffer timber from terminated sales in consonance with its normal sale program and in light of the market's ability to absorb the reofferings. That course would seem likely to produce more revenue for the government than would forced sales into an unwilling market.

Reoffering defaulted sales under their original conditions would require using former contract provisions which were abandoned earlier this year when the Forest Service increased the financial obligations of purchasers. Those changes were intended to reduce speculation in timber. Offering a number of contracts with the old terms could create an unwarranted two-tier sale arena.

Even if sales were promptly resold under the older contract terms, the Forest Service would incur the legal costs and time of trying to win a judgment in court for the contract value lost on resale. Once a judgment was won, the problem would remain of how to collect it. Companies defaulting on sales could well be bankrupt or otherwise out of business by the time any judgment was rendered.

Defaults are also a much worse outcome for county governments, which share in timber revenue to the federal government. Counties would get no share of any default judgment which might be collected, and they would receive less from a forced default resale than they likely would get from an orderly termination resale.

In sum, by standing pat on a harvest-or-default policy, the government could do itself more harm from both a revenue and policy standpoint than if it permitted an orderly termination and resale of a significant portion of the highest-priced sales.

D. Massive Defaults Would Consolidate the Industry in a Manner Harmful to the Government's Longterm Financial Interest and the Public Interest.

The timber industry presently includes numerous independent, privately held companies which compete strongly against each other. Although a few large and sometimes diversified companies in the industry are well known to the general public, the industry is not highly concentrated.

If companies are forced into massive defaults on existing federal timber contracts, however, the result for many will be bankruptcy or other forced exit from the industry. That would tend to consolidate the industry to no public benefit. Less competition in the long run would reduce government revenues from timber over what revenues would be from a more internally competitive industry.

The shutdowns and work curtailments of the present depression have had a devastating effect on many communities. This would be magnified if the shutdowns were permanent. Unlike many industries which cluster in large metropolitan areas, the timber industry has many of its facilities in small communities which have little or no other economic base. A mill closing can mean the death of such communities, leaving residents jobless and with property losses that can wipe out their lifetime savings.

E. There is Nothing Unique About Parties to a Contract Modifying the Contract when Unforeseen Circumstances Arise.

Government's relation to timber companies in this situation is much like that of another private party in a routine business arrangement. It is not unusual for a contract to be changed when events arise which were not expected when the contract was signed. Government is more frequently the purchaser than the seller in contracts. Terms often are changed in longterm procurement contracts when unexpected situations arise. But the principle should be no different here where government happens to be the seller and it is to the parties mutual advantage to work out an orderly change rather than stand by a chaotic status quo.

IV. The Timber Industry Has Negotiated at Length to Develop a Proposal That Does Not Benefit One Segment of the Industry Alone at the Expense of Others.

A. Industry First Began Discussing Contract Terminations in Autumn 1981.

In late 1981, it began to become apparent that the timber industry was suffering more than its typical one-year down cycle. Some members of the industry from western Oregon began exploring whether allowing termination of federal timber contracts might be the best way to resolve that clearly was getting out of the ordinary. Reps. James Weaver and Les AuCoin of Oregon introduced separate contract termination bills, and hearings were held in Chairman Weaver's House Agriculture forests subcommittee.

B. A Western Industry Proposal Evolved Under the Auspices of Senators Hatfield and McClure.

Early in 1982, Sen. Mark Hatfield of Oregon suggested one means of helping Oregon mills beset by high raw materials costs and counties plagued by declining timber revenues: roll back the contract price of timber on the Bureau of Land Management's O&C timber lands in Oregon. Counties apparently believed this would be the quickest route to increasing timber harvests so that county revenues would rebound.

The notion of a benefit only for companies operating on the O&C lands was opposed by operators in the inland area of the west, who expressed their views to Sen. James McClure of Idaho. Sen. Hatfield and Sen. McClure discussed the matter. They ultimately oversaw the formation of an industry committee from Oregon and Idaho which they asked to return with a proposal for contract modification which both sides could agree on.

This eight-member committee met several times in Washington D.C. and in the west, as did executives from several of the timber industry associations based in those regions.

Participants recognized that any significant program would have to effect more than just BLM contracts in order to avoid benefitting only one segment of the industry. The BLM sells approximately one-tenth as much timber in its Oregon operation as the Forest Service sells nationally. While the Oregon operators favored a program permitting unrestricted termination of contracts, the Idaho operators expressed concern that this would give a big market advantage to operators in the higher-priced areas, where a termination would be worth more than in low-priced areas such as Idaho. The Idaho operators also said their bigger problem during the industry downturn was having to pay more of the share of building roads to be included in the permanent National Forest Road System. The elimination of the "ineffective purchaser road credit" was both needed and justified in principle as a source for relief.

The committee ultimately reported to Sens. Hatfield and McClure and at a meeting with the senators, completed work on a three-point program for industry legislation. The three elements would entitle each operator to:

(1) terminate federal timber sale contracts covering approximately 40 per cent of the operator's volume under contract;

(2) Extend for five additional years without financial penalty the expiration date of any contract not terminated; and

(3) Receive full purchaser road credit without regard to the price of timber in the contract under which the road was built, with such credit to be transferrable and applicable anywhere in the National Forest System.

The working out of details and drafting of legislative language embodying this proposal then began within industry. During both the negotiation of the three major points and the evolution of details, it was apparent that while virtually no one believed this proposal would have been his personal first choice to most benefit his company, it was a reasonable compromise among divergent views and industry situations that the greatest number could accept and endorse it as providing the highest degree of benefit under these different circumstances to the lumber community.

C. Industry in the West Made Concessions to Concerns Voiced by Industry in the South, but a Difference on One Point has Forestalled General Industry Agreement on the Proposal to this Point.

The western industry draft was generally circulated. Some operators in the south voiced concern that any large volume of terminated timber might reenter the market in addition to the regular Forest Service sales program. This, they feared, would lead to abnormally low timber prices in the west and result in market dislocation at the expense of the south. In light of statements from the Department of Agriculture that terminated volume would be reoffered as part of the regular sale program, the west did not believe the south's fears would be realized.

The south, however, proposed that any legislation include some additional limitation on timber sales in the west to insure against market dislocation. The west indicated it would not object to legislative direction that resales be part of the regular sale program. The south suggested a precise board-feet limitation on sales in Forest Service Region 6 during fiscal years 1983 and 1984. The two sides sparred for a time over different numerical limitations and whether they should apply to all of Region 6 or only to the west side of Region 6--western Oregon and western Washington. Ultimately, they could not agree on a numerical sales limitation.

Although the west was willing in the spirit of compromise to accept a fairly strict numerical limitation, the west is very concerned that a limit set now on sales in 1983 and 1984 could artifically constrain raw material supply later in the 1980's. In light of the inability to agree on a number, the proposed industry bill reverts to the more general form of limitation on resales, which the west believes adequately protects against market dislocation.

D. The Industry Proposal Includes Compromises Developed with the Administering Agencies and Congressional Staff Members.

During the course of drafting its proposals, industry worked closely with the staff of Senator Hatfield, which in turn involved the Forest Service, Bureau of Land Management, and legislative counsel of the Senate. Although Senator Hatfield ultimately introduced legislation not proposed by industry, many of the results of the consultations with his staff and the others are reflected in the industry proposal.

V. The Industry Believes its Proposal Best Meets the Needs of the Federal Government, Local Communities and their Governments, Workers, and Businesses.

The text of the industry proposal is enclosed with this statement and is formally submitted for the record and for consideration of the Committee in its markup of legislation.

A. Purchasers Should be Entitled to Terminate Approximately 40 per cent of their Federal Timber Under Contract.

Section 1 of the proposal authorizes the Secretaries of Agriculture and the Interior to terminate contracts for the purchase of timber which were bid prior to January 1, 1982. Section 2 mandates and sets the limitations on the termination program, and Section 6 requires prompt implementation. Provisions of the termination program include as follows:

1. Timing.

The Secretaries would be directed to publish procedures implementing the program within 30 days after enactment of the Act. Purchasers then would have 45 days in which to file written requests for terminations of contracts. Contracts which otherwise would expire after enactment but before implementation of the program would be preserved for participation in the program. The condition of the industry makes rapid action highly important, thus the strict time limit for getting the program underway. Purchasers would have to make their decisions promptly as well, so they could not have the opportunity for extended speculation over whether a sale should be held or terminated.

2. Volume to be Terminated.

Purchasers would be entitled to terminate 40 per cent of their timber volume under contract with both Secretaries as of April 1, 1982. Because it is highly unlikely that any combination of terminated sales would total exactly 40 per cent of volume under contract, purchasers could "round up" their terminated volume by terminating one additional sale so long as the total volume terminated including the additional sale did not exceed the 40 per cent limitation by more than 10 million board feet. The one additional sale would have to be more recently bid than any of the other sales terminated by the purchaser.

Small businesses holding only one or two sales might find that they could not terminate a sale under the 40 per cent limitation. Therefore, an alternate termination entitlement of either 15 million board feet or one contract is provided.

3. Qualifying Date of Sales to be Terminated.

To be eligible for termination, a sale would have to have been bid prior to January 1, 1982. Beginning in 1982, the agencies began to offer a number of short-term sales in an effort to bring more realistically priced timber onto the market. These more recent sales would not be eligible for termination, although, as noted above, sales bid prior to April 1, 1982 would be used in calculating a purchaser's volume of termination entitlement.

4. Condition of Sales to be Terminated.

Sales on which no harvesting has taken place could only be terminated in full. A purchaser could not turn in one part of a sale while retaining another part.

Sales on which partial harvesting had taken place could be terminated only after work was completed on identifiable units or other logical portions of the sale as determined by the Secretary.

The Secretary could refuse to terminate the contract of a partially cut sale if he determined that remaining unharvested units were not representative of the entire contract area in terms of species and logging methods.

Partially cut sales must be eligible for termination or else the termination program will be too limited in its practical application. At the same time, the Secretary must be given authority to reject termination where he finds a purchaser has taken the cream from a sale area and left only the skim milk.

5. Costs.

A terminating purchaser would be required to pay a termination fee of $3 per thousand board feet of terminated volume. This payment would cover the cost of reoffering the sale and would be in lieu of any damages, penalties or other claims.

The $3 charge is based on cost determinations made by the Forest Service that it will cost $1 per thousand board feet to reoffer an untouched sale and $6 per thousand to reoffer a partially cut sale. A termination charge formula is considered much more administratively efficient than trying to calculate the actual reoffering costs of each sale.

6. Road-Building Requirements.

The Secretary could require a terminating purchaser to complete any roads specified in a contract and to deck the right-of-way timber cut during such road building. This requirement is designed to insure that the termination of a sale would not block access to another sale which is dependent on a road that was to be built in the terminated sale. The decked right-of-way timber could be sold by the agency to a willing buyer.

7. Road Credits from Terminated Contracts.

Purchaser road credits remaining on a Forest Service sale after setoff against amounts owed by the purchaser to the Secretary of Agriculture could be transferred to other contracts held by the purchaser, retained on account with the Secretary by the purchaser, or transferred to another party with all rights. Subsection C below more fully discusses the industry's purchaser road credit proposal, which this provision implements as to terminated contracts.

A purchaser terminating a contract with the Department of the Interior who had completed roads under that contract would be credited, after setoff, for the value of the roads as set in the contract appraisal allowance. That credit could be transferred to other contracts with the Secretary of the Interior held by the purchaser, retained as a credit with the Secretary, or transferred to another party with all rights. This would reimburse the purchaser for value provided to the Secretary without consideration. Normally, a bidder for an Interior sale pays the cost of the road but takes that cost into account in making his bid. Thus, he is actually paid for the road through the value of the harvested timber.

8. Limitation on Resales of Terminated Timber.

Terminated Forest Service contracts would be resold only as part of the agency's normal sale program. This is intended to prevent flooding of the timber market with sales in excess of the normal sale program, and any possible regional dislocation that might result.

9. Eligibility for Bidding on Resales.

Terminating purchasers would be eligible to bid on the resale of their terminated contracts.

B. Sales Not Terminated Should be Extended by an Additional Five Years Without Financial Penalty.

Section 1 of the proposal authorizes the Secretaries to extend timber sale contracts under the program mandated in Section 3. The provisions of the extension program are as follows:

1. Timing.

Implementing provisions would be published by the Secretaries within 30 days of enactment of the Act in accordance with Section 6. Extension requests would be made prior to the termination date presently in effect for the contract. Extensions would be for five years from the termination date in effect at time of enactment of the Act.

2. Contracts Eligible for Extension.

To be extended, contracts would have to have been bid prior to January 1, 1982. Contracts sold this year would not be eligible for extension. To permit extensions of these contracts would defeat the purpose of the short-term sales offered this year. There is no timber volume limit on the aggregate of contracts to be extended. However, contracts involving substantial amounts of timber subject to rapid deterioration could not be extended except with approval of the Secretary. Permitting unqualified extension of such deteriorating timber would waste the resource. Permitting termination of such contracts, however, enables the agency to resell quickly to a willing harvester.

3. Conditions of Extension.

The Secretary may require an extending purchaser to complete road construction required by the contract. This is to avoid access being blocked to other sales as a result of the extension.

Extending purchasers would have to remove 25 per cent of the estimated timber volume by the end of the third operating season of the five-year extension period, or pay 25 per cent of the contract price by the start of the fourth operating season of the extension period. This provision is designed to insure that some work will progress during the course of the extension, and that operators will not leaves sales untouched until the end, then seek further extensions or terminations. This provision reflects a particular concern of industry in the south.

C. As Part of a Program to Meet the Industry Depression, the Forest Service Should More Fully Pay the Costs of Roads Built Under Timber Contracts and Designed for Inclusion in the Permanent National Forest Road System.

On many timber sales, roads must be constructed in order to provide access. The Forest Service requires roads built to be adequate to log the balance of the timber adjacent and tributary to the road but not included in the sale, and for future management of the land, as well as such non-timber uses as hunting, fishing, and other outdoor recreation activities. These are designated for inclusion in the permanent National Forest Roads System. Such permanent roads are built to higher standards than would be necessary for the specific timber sale. Therefore, when the timber purchaser builds a permanent road for the Forest Service, he is given a credit for those construction costs. The

purchaser's position is theoretically similar to that of any contractor building a federal highway--he provides a benefit to the government and gets paid for it. Rather than receiving a cash payment, however, the timber purchaser receives a credit which he can apply against certain timber he harvests.

A problem with purchaser road credit is that there are many instances where the credit can never be taken, or can be taken only after significant time delay. The result is that the purchaser is in some cases donating part of the road to the government, and in other cases is providing the equivalent of an interest subsidy to the government.

So-called "ineffective" purchaser road credit arises when the value of timber on a sale in excess of the statutory base rate is less than the estimated cost of the road construction required under that sale contract. The base rate is a portion of the timber value which must be paid in cash, not credits. The remaining value can be paid in purchaser road credits. But credics in excess of the remaining value presently are valueless.

Sales whose stumpage price escalates or de-escalates based on the market may have originally had adequate stumpage value to absorb road credits. But in a market decline such as now, the stumpage value may de-escalate below the amount needed to absorb road cost, and may require cash repayment in lieu of road credits already used which have now been transformed from effective to ineffective.

"Effective" purchaser road credits can be used to pay for timber not only from the sale where the road was built, but for any other sale in the same National Forest. If a purchaser has more than one sale operating in a suitable sequence in the same National Forest, he ideally can utilize his credits soon after they are earned. But in other situations, the purchaser may be unable to use his credits for perhaps one or two years, thus providing the equivalent of an interest-free loan to the government.

Some purchasers, faced with the knowledge that some of their road credits on a particular sale will be ineffective, bid the price of the sale up to the level where all the credit will be effective. This costs the purchaser nothing, and may provide a cash flow advantage if he has another sale in the same forest on which to use the credit. These cash strategies, however, are somewhat artificial.

Industry proposes that the timber purchaser subsidy to government road building be ended by making all purchaser road credits effective, permitting them to be utilized anywhere in the National Forest System, and making them freely transferable among purchasers. This creates a much greater degree of equity between purchasers and the government, and between different purchasers.

Most sales with ineffective road credits--called deficit sales--typically are east of the summit of the Cascade Range and in the Rocky Mountains, areas where timber prices are lower than in such areas as western Oregon and western Washington. Increasing numbers of sales in California and the west side of Region 6 also are deficit in the present market. Providing relief to purchasers from the subsidization of government roads would importantly help them weather the present timber depression as well as end an unwarranted private subsidy to the United States. Operators in the inland area will be less helped by contract termination than operators in high-priced areas, so this element of the industry proposal would significantly balance the benefits of legislation.

The industry proposal would make effective the ineffective purchaser road credits earned under contracts still in effect, and would make all future road credits effective.

Some opponents of the purchaser road credit proposal argue that it would make marginal timber sales in the inland area more attractive to operators and thus would increase the development of presently roadless areas. Industry believes, however, that there are likely to be fewer roads built in roadless areas of the inland region because the government will have to, in one way or another, more fully pay the cost of these roads.

D. By Exercising the Termination and Extension Entitlements Proposed, a Typical Western Oregon Company Would Break Even Financially Through Most of the Rest of the 1980's.

The industry's proposed 40 per cent/60 per cent division between terminated timber volume and extended volume provides a average western Oregon operator with an apparent opportunity to break even by the end of the decade on timber retained with extensions. The chart attached as Appendix D contains supporting calculations.

Reaching a break-even point in 1989 assumes that an operator terminates his highest-price timber and cuts most of his extended volume in the final two years of the extension period. The calculation further assumes the assistance of a 7 per cent inflation rate. The operator is assumed to make a 10 per cent profit on all new purchases of timber and to apply this profit against losses incurred on the extended timber. If the inflation rate were 10 per cent, the break-even point would be reached in 1987--still five years from now.

E. Some Jobs Would be Restored by the Industry Proposal, and Many Other Jobs Would Be Poised for Quick Restoration When Markets Improve.

It is important to remember that any form of contract modification, whether it be termination, extension or price rollback, cannot in and of itself create additional markets for lumber and plywood. What modification can do is enable operators to retain their share of the present depressed markets as opposed to losing further market share or leaving the market entirely due to business failure. Moreover, contract modification will enable companies to promptly increase their production as markets revive.

The industry's proposed terminations and extensions both provide for prompt building of roads at the discretion of the Secretaries. These roads would not be built if contracts were defaulted until the timber was reoffered and resold. Thus, the industry program will more quickly create and retain road-building employment than would taking no action and inducing massive defaults.

VI. Other Legislative Proposals Contain Shortcomings as Compared To the Industry Proposal.

A. The Hatfield Bill Offers A Generally Suitable Framework for the Industry Proposal, But Contains Two Provisions Not Favored by Industry.

The Hatfield Bill, introduced by Senator Hatfield as S. 2805 and by Representative Weaver as H.R. 6913, broadly authorizes the Secretaries of Agriculture and the Interior to modify timber sales contracts bid prior to January 1, 1982. It specifically

lists as permissible modifications the termination, extension, or purchase price modification of such contracts. The Secretaries are directed to publish procedures for the modification of contracts within 30 days of enactment of the Act.

This bill provides a suitable framework for the industry proposal. The specific provisions of the industry proposal should be included in S. 2805 and H.R. 6913, however. In their present very general form, virtually complete discretion is left to the agencies. In light of the delicate balance among various regions, communities and businesses who are vitally concerned with this issue, it is preferable for Congress to more specifically direct the agencies what actions they should take. Even in the industry proposal, much implementing detail is left to the agencies' discretion. But the broader policy parameters should be spelled out in legislation.

In addition to the broad issue of how much discretion to leave to the agencies, two specific provisions of S. 2805 and H.R. 6913 are of particular concern to industry.

Section 2 authorizes the Secretaries to act only "upon a showing of economic hardship by the private contracting party". It is not specified whether this is to be economic hardship relating to the specific timber contract at issue, or whether it is to be economic hardship relating to the purchasing operator as a whole. If the hardship relates only to the specific contract, industry's concern is less, since there would be no seek termination or extension of the contract if it were economically viable to operate. If the hardship is to relate to the entire company, however, industry would be gravely concerned about the kinds of tests to be set and the inequities among purchasers which would likely result. In the course of developing its proposal, industry considered whether hardship qualifying tests should be set and concluded there was no equitable measure that could be practically used. Company size was not proper, because some large companies as well as small are in poor condition. Volume of timber under contract is not relevant. Profit or loss for the most recent period is not an accurate indicator because it is unrelated to the immediate future problems of the timber volume under contract and its price. A portion of the industry depression problem is faced by company's who have no timber under contract because they were frozen out by high bidding in previous years. These companies could get inadequate access to resale of terminated volumes if companies in their vicinity were judged to have no economic hardship and thus could not terminate sales. A company's relative hardship position also could change depending on whether its nearby competitors qualified and were able to terminate sales, thus sharply reducing their price of raw material while the supposedly healthier company was left with only high-priced raw material. Given the relatively short time left before this program should be implemented in order to be effective, the time required to develop any economic hardship test would be a further problem.

Industry also has strong doubts about rolling back the prices of existing contracts. The goals of price rollback and termination are the same: to make more timber available to the present market at prices that reflect the present market. Rollback would achieve this by lowering the prices for existing contract holders. Termination would achieve this by reoffering terminated sales to any purchaser under bidding that would reflect the current market. The industry has been criticized for creating its own problem due to high bidding that took place in the late 1970's and start of the 1980's. Rolling back prices for the winning high bidders of that period would grant them a benefit while providing no opportunity to reenter the market for purchasers who stayed out of that bidding. Termination would

start the game over again for everyone equally under the new ground rules of the present market, favoring neither past bid winners nor companies who forewent those price levels. Industry believes, therefore, that terminations are a more equitable approach to the goal of putting timber back on the market at today's market prices.

B. The McClure Extensions Bill Offers One Form of Immediate Relief But Only Postpones the Problem.

Legislation introduced by Senator McClure as S. 2818 would provide only for a five-year extension of timber sale contracts. Extensions alone serve only to postpone the immediate crisis deadlines caused by the timber depression, but do not offer a solution reasonably likely to enable operators to emerge from the depression in minimally acceptable business condition.

A table compiled by a wester Oregon lumber company and attached as Appendix E illustrates how extensions are insufficient by themselves. From 1977 through the first half of 1980, market prices for a benchmark lumber commodity remained higher than, and rose in general accord with, the cost of the product, including stumpage, logging cost and cost of manufacture. Based on Federal timber sales under contract in western Oregon, the product cost continues to rise steadily through 1986. But the drop in product price from mid-1980 to date leaves the price well below the cost of manufacturing from present federal contracts. Thus, the product can't be manufactured except at great economic loss. Even assuming a 15 per cent annual increase in product price (well above projected inflation rates), the price won't come near catching up with costs. Extending contracts enables producers to put off cutting the high-priced timber, but doesn't leave sufficient time for the price to catch up to costs. As discussed above, 60 per cent extensions coupled with 40 per cent terminations would allow a typical operator to break even by near the end of the decade. But 100 per cent extensions and no terminations would put the break-even point off until well into the 1990's or perhaps even the turn of the century, depending on the inflation rate.

Forcing operators to retain all present contracts, even with extensions, hinders their ability to purchase present timber supplies at prices reflecting the current market. It also reduces the selection of timber available to the agencies to offer in expectation of providing realistically priced raw material.

VII. CONCLUSION: For the Reasons Stated Above, Congress Should Enact the Proposal Developed by Industry.

APPENDIX A

REMAINING VOLUME UNDER CONTRACT BY PRICE
FOREST SERVICE - REGION 6

Period Ending 3/31/82

WESTERN OREGON

MBF	%	Stumpage Price Range $/M	Delivered Pond Cost $/M
35,954	0.5	N/A	0
456,801	5.8	1-100	239
461,467	5.9	101-150	285
651,183	8.3	151-200	317
745,887	9.5	201-250	373
1,043,079	13.3	251-300	411
1,106,783	14.0	301-350	467
1,030,418	13.1	351-400	512
961,624	12.2	401-450	563
658,876	8.4	451-500	600
386,588	4.9	501-550	661
90,903	1.2	551-600	709
73,172	0.9	601-650	779
46,770	0.6	651-700	830
7,270	0.1	701-750	939
103,901	1.3	751+	1,103
7,860,676	100.0		469

EASTERN OREGON

31,505	0.9	N/A	0
1,189,649	32.7	1-100	199
502,786	13.8	101-150	251
572,565	15.8	151-200	307
576,268	15.9	201-250	341
396,725	10.9	251-300	378
193,416	5.3	301-350	418
145,060	4.0	351-400	456
25,700	0.7	401-450	516
0	-	451-500	0
0	-	501-550	0
0	-	551-600	0
0	-	601-650	0
0	-	651-700	0
0	-	701-750	0
0	-	751+	0
3,633,674	100.0		290

Source Data: Timber Data Co. from USFS
Compiled by: W.R.A., 5/3/82

APPENDIX A (cont.)

REMAINING VOLUME UNDER CONTRACT BY PRICE
FOREST SERVICE - REGION 6

Period Ending 3/31/82

WESTERN WASHINGTON

MBF	%	Stumpage Price Range $/M	Delivered Pond Cost $/M
26,352	0.7	N/A	0
992,706	24.9	1-100	231
568,075	14.3	101-150	263
707,249	17.8	151-200	323
432,125	10.8	201-250	366
445,424	11.2	251-300	406
290,401	7.3	301-350	444
325,939	8.2	351-400	524
84,136	2.1	401-450	529
39,427	1.0	451-500	599
33,500	0.8	501-550	622
37,500	0.9	551-600	664
0	-	601-650	0
0	-	651-700	0
0	-	701-750	0
0	-	751+	0
3,982,834	100.0		344

EASTERN WASHINGTON

12,516	1.0	N/A	0
723,928	56.8	1-100	201
337,891	26.5	101-150	254
146,661	11.5	151-200	297
34,810	2.7	201-250	379
6,400	0.5	251-300	343
12,300	1.0	301-350	424
0	-	351-400	0
0	-	401-450	0
0	-	451-500	0
0	-	501-550	0
0	-	551-600	0
0	-	601-650	0
0	-	651-700	0
0	-	701-750	0
0	-	751+	0
1,274,506	100.0		234

Source Data: Timber Data Co. from USFS
Compiled by: W.R.A., 5/3/82

APPENDIX B

TIMBER VOLUME UNDER CONTRACT
BY PURCHASER

Western Oregon
Region 6 - U.S. Forest Service

As of March 31, 1982

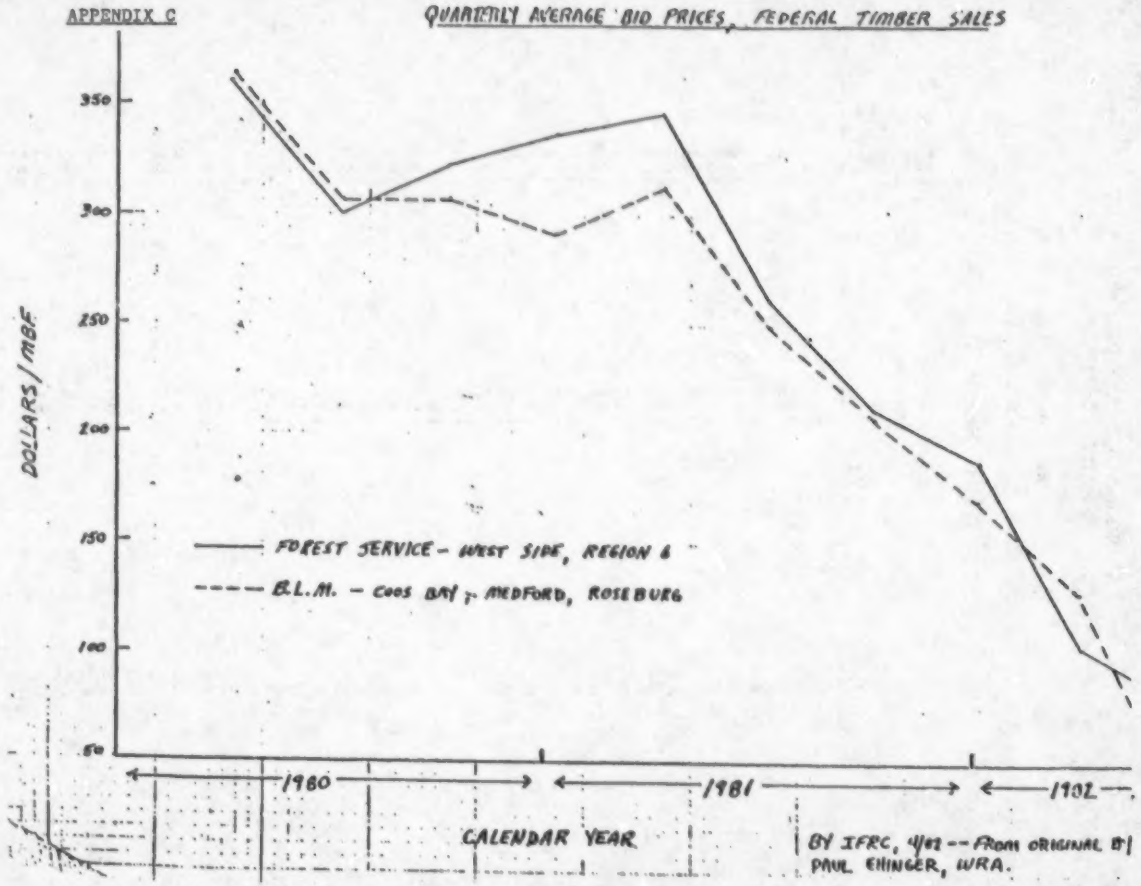
PURCHASER	VOLUME UNDER CONTRACT (MMBF)	AVERAGE MERCH. STUMPAGE $ PER MBF
A	623	346
B	429	212
C	316	261
D	299	322
E	281	352
F	280	334
G	276	306
H	268	358
I	240	297
J	236	470
K	225	299
L	212	375
M	195	274
N	188	320
O	182	384
P	176	298
Q	167	364
R	150	341
S	143	368
T	136	278
U	133	320
V	132	304
W	130	330
X	116	192
Y	113	378
Z	108	387
AA	105	448
BB	103	391
CC	101	594
DD	101	274
EE	99	280
FF	86	434
GG	85	252
HH	84	253
II	83	386
JJ	72	180
KK	62	247
LL	56	287
MM	51	271

* Names have been removed, but each letter represents an actual, separate company.

Source Data: Timber Data Co. & U.S. Forest Service

June 1982

APPENDIX C


QUARTERLY AVERAGE BID PRICES, FEDERAL TIMBER SALES
DOLLARS / MBF
350
300
250
200
150
100
50
FOREST SERVICE - WEST SIDE, REGION 6
B.L.M. - COOS BAY, MEDFORD, ROSEBURG
1980
1981
1982
CALENDAR YEAR
BY IFRC, 4/82 -- FROM ORIGINAL BY PAUL EHINGER, WRA.

APPENDIX D

CALCULATION ON PROJECTED AVERAGING OF STUMPAGE

WESTERN OREGON
REGION 6 - U.S.F.S.

YEAR	AVERAGE MERCH. MARKET LOG COST (INCREASE 7%/YEAR)	AVERAGE MERCH. MARKET LOG COST (INCREASE 10%/YEAR)	10% PROFIT ON LOG COST (INCREASE 7%/YEAR)	10% PROFIT ON LOG COST (INCREASE 10%/YEAR)	LOG COST W/40% TERMINATION (LOGGING COST INCR. 5%/YEAR)	LOSS/M (COL.5 LESS TOTAL COL. 1 & 3) (INCREASE 7%/YEAR)	LOSS/M (COL.5 LESS TOTAL COL. 2 & 4) (INCREASE 10%/YEAR)	% THAT CAN BE TERM. FOR BREAKEVEN ON ANNUAL VOLUME CUT (INCREASE 7%/YEAR)	% THAT CAN BE TERM. FOR BREAKEVEN ON ANNUAL VOLUME CUT (INCREASE 10%/YEAR)	ACCUM. % (INCREASE 7%/YEAR)	ACCUM. % (INCREASE 10%/YEAR)
1982	$230	$230	$23	$23	$380	$(127)	$(127)	--	--	--	--
1983	246	253	25	25	385	(114)	(107)	18%	19%	18%	19%
1984	263	278	26	28	390	(101)	(84)	20%	25%	38%	44%
1985	281	306	28	31	396	(87)	(59)	24%	34%	62%	78%
1986	301	337	30	34	402	(71)	(31)	29%	52%	91%	130%
1987	322	371	32	37	408	(54)	(0)	36%	100%	127%	230%
1988	345	408	34	41	414	(35)	--	48%	--	175%	
1989	369	449	37	45	420	(15)	--	69%	--	244%	

NOTES

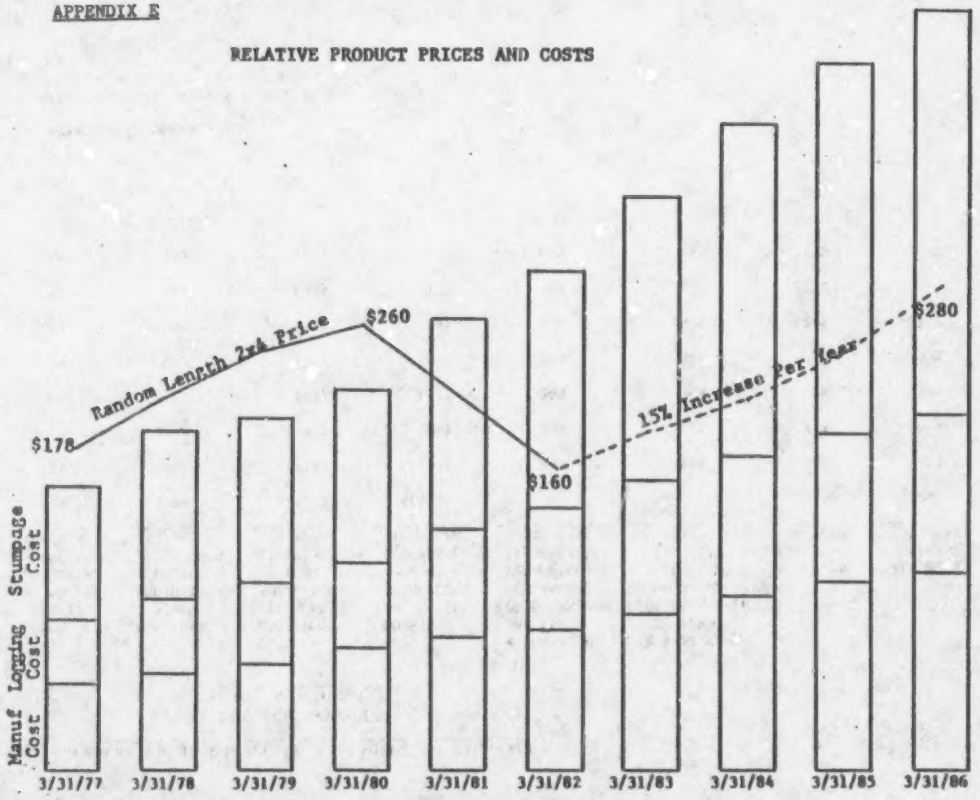
1. Logging cost assumed to be $100.00/M for increases in Column 5.

2. At 40% termination, 180% of one year's cut will remain assuming a 3 year timber supply. Averaging complete when in Columns 10 and 11 the accumulated % passes 180%.

Calculated by: Western Resource Alliance
6/24/82

APPENDIX E

RELATIVE PRODUCT PRICES AND COSTS



Notes: 1) Based on USFS & BLM Sales currently under contract.

2) Assumes two-year extensions on BLM & USFS

STATEMENT OF

RALPH D. HODGES

EXECUTIVE VICE PRESIDENT OF THE

NATIONAL FOREST PRODUCTS ASSOCIATION

I am Ralph D. Hodges, Executive Vice President of the National Forest Products Association. Headquartered in Washington, D.C., NFPA is a federation of twenty-nine regional, product and species associations and fifteen direct member companies. NFPA represents the growers, manufacturers, and wholesale distributers of solid wood products throughout the United States. I am here today to represent the NFPA on the issue of federal timber sale contract modification as it is treated by S.2805, to provide for the termination, extension or modification of Federal timber sale contracts, and S.2818, a bill to provide for adjustment of termination dates of federal timber sale contracts.

NFPA welcomes this hearing on legislation dealing with general concepts of relief for purchasers of federal timber. We applaud your helpful efforts in dealing with serious problems stemming from the recent long period of economic decline, and a depressed market for timber and other wood products. These factors result from a series of government actions which contributed to both inflation and extraordinarily high interest rates. In the face of this dismal economic situation, many purchasers must deal with the prospects of completion of federal timber sale contracts, which have purchase prices too far above break-even points in today's markets. The potential impact of this situation on the very survival of many producers is well covered in Senator Hatfield's introductory statement.

The NFPA has served as a forum, focal point and clearinghouse for the various industry views on the issue for most of this year. With some understandable and strong exceptions, there

has been a growing trend toward agreement that a legislative solution is preferable to the uncertain, chaotic, and long drawn out result that is likely should legislation not be enacted.

At this time, however, NFPA members have widely differing views on the concept of relief and the specific provisions of the bill, and NFPA is not in a position to support S.2805 or S.2818.

However, there has been a growing agreement within the industry on some major elements of any legislative package. These are: (1) Termination of up to 40% of a Purchaser's volume under contract, and (2) a five-year contract term adjustment for sales that are not terminated.

Also, many feel strongly that any action taken by the government to alleviate this difficult situation should not distort the normal competitive market system. Because of the extraordinarily large volume of federal timber under contract in the northwest, there is fear that terminated or defaulted contracts could force large amounts of timber on the national market all at once when national consumption remains at historic lows. Without increased demand, increased flows of timber from one section of the country could affect markets in another section. Thus, there is agreement among those supporting legislation that the bill should spell out that terminated or defaulted timber be marketed by the Government in an orderly way. However, there is not yet agreement as to how guidelines for this concept should be spelled out.

Before looking at S.2805 and S.2818, I would like to give you some background on the current problem and the reasons why there is a growing pressure in the industry for a legislative solution.

BACKGROUND

In the Fall of 1981, Purchasers of federal timber in the West and the Forest Service became concerned about the increasing

volume of timber under contract that was priced too high to be cut under current or future market conditions. The volume of uncut timber under contract increased. This occurred because the falloff in demand for wood products reduced end product prices to the point where Purchasers could not afford to harvest timber without sustaining substantial financial losses.

High Contract Costs

Bid values for national forest timber rose dramatically in the 1970's. For example, prices for Douglas-fir, the principal species in the Pacific Northwest, rose from an average of $41.90 per thousand board feet (MBF) in 1970 to $432.20 per MBF in 1980, a 931% increase. This increase resulted from a myriad of conditions. These include a perceived shortage of available timber due to uncertainties over Federal wilderness policies and land allocation for other non-timber uses, in addition to increased competition for available timber supply.

The Forest Service projected in the early 1970's that housing starts would average 2.6 million throughout the decade of the 1980's. Some Purchasers believed these and other factors required them to pay high prices for raw materials or be without a supply of timber for their mills. Thus, for a decade inflation and the threat of shortages encouraged purchasers to bid higher than current markets allowed and still operate profitably because most sales were not cut until 2-5 years later.

Housing Starts Decline

In the Fall of 1979, the Federal Reserve Board tightened the growth of the money supply in an effort to control inflation. This action resulted in higher borrowing rates as competition increased for available money, particularly with huge federal defaults. The traditional systems of home mortgage financing were changed. Long-term mortgages, the primary lending vehicle for home financing, fell victim to increasing rates. Most of the

98-286 O - 82 - 9

contracts that are currently uneconomic to operate were bid prior to this major reversal of federal housing and monetary policy.

As interest rates rose, home sales fell. Housing starts dropped from an average of 1.77 million during the decade of the 1970's to 1.1 million in 1981. This drop had a devastating effect on the timber industry nationwide. Roughly half of the softwood sawtimber produced in the United States is used for new home construction. As housing demand diminished, the demand for wood products fell with it. The situation worsened in 1982.

The reduced demand for wood has caused end product prices to drop to the point where many timber purchasers can not afford to manufacture lumber and plywood without incurring substantial losses. As a result, timber that had been purchased under the high bid prices of the late 1970's is left standing in the national forests unharvested.

Timber Sale Contracts

The Forest Service sells public timber from the national forests in parcels on a competitive bid basis. When a high bidder on a timber sale signs a contract for a parcel of timber, he agrees to harvest the timber within a stated time period. The length of contract varies by geographical region and the amount of timber included in the sale. Road building and environmental safeguards can increase the term of a contract by one or more years. A typical contract length in the Pacific Northwest is 3 to 4 years.

The Forest Service's interest is to have contracts carried out. It recently recognized, however, that many timber sale contracts would be defaulted unless the terms were adjusted. Accordingly, it announced in early 1980 that a one year extension of contracts would be provided due to the severe falloff in demand for wood products. Throughout 1980 and most of 1981, market conditions did not improve. In response, the Forest

Service announced in October, 1981 that it would offer a two-year extension of existing contracts. By May of 1982, market conditions had deteriorated to the point where many purchasers could not pay contract extension deposits, a requirement of extension. To prevent further hardship, the Forest Service granted a waiver of extension deposits but required that interest payments be made or be accrued on unpaid balances owed to the government.

This action, though temporarily favorable to many federal timber buyers, only delays the serious problems that still confront them.

Another serious problem area is the difference between the timber appraisal system in the Southern Region and that which applies in other Forest Service Regions. In this depressed market the "transaction evidence" system in the South lags well behind the actual end product values which are more promptly and accurately reflected in the western "residual value" system. This serious differential must be corrected.

Why Contract Relief is Proposed

Federal timber production is a primary industry in many Western states, with a large segment of the industry dependent on national forest timber for its raw material supply. But this is a national problem, and not just a western concern. Although private timber predominates in the South, the possibility of a glut of timber flooding a static national market could affect traditional southern markets as well.

Without a legislated solution, purchasers may have little choice but to default on many contracts. When and how this occurs is not predictable. Substantial defaults could disrupt normal market patterns because to determine damages, the defaulted timber would be readvertised and resold immediately. Law suits would be likely, and damage collection uncertain. It seems clear that without legislative relief or dramatic market improvement many companies in the timber industry, particularly the small indepen-

dent operators who own little or no timber, will be in more than normal jeopardy.

The Provisions of S.2818

S.2818 would embrace the concept of contract term adjustment which has been included in various drafts considered by the industry. This concept has wide support within the industry, but others believe this provision alone will not solve the fundamental problems.

The Provisions of S.2805

S.2805 would provide authority for termination of an unspecified portion of sales held by a purchaser. The 40% limitation that has emerged with considerable industry support is quite important to many operators. Also the bill does not include provisions relating to purchaser credit, a vital concern for many operators in the intermountain region. The "price rollback" provision is strongly opposed by parts of the industry. It reduces the price of timber but still implies a requirement to immediately harvest that timber despite very low demand for lumber.

CONCLUSION

During these hearings you will hear a wide range of views from the forest industry. Your record will be full, and the issues clarified. We urge you to continue your leadership role in trying to forge a solution to this catastrophic problem. We pledge our support during the process in aiding the Congress and the industry in finding the best approach to the issue.

I will be glad to answer any questions you may have.

TESTIMONY OF JOHN C. HOOPER

SIERRA CLUB NATIONAL CONSERVATION REPRESENTATIVE

ALSO REPRESENTING THE NATIONAL AUDUBON SOCIETY

Mr. Chairman, my name is John Hooper. I am representing the Sierra Club, a national conservation organization with more than 300,000 members. I am also representing the National Audubon Society, a national conservation group with nearly one half million members. Thank you for this opportunity to testify on S. 2805, a bill to provide for the termination, extension or modification of certain contracts for the sale of federal timber.

The Sierra Club and the National Audubon Society have worked since their beginnings to encourage forest practices which will both assure a sustained yield of high-quality timber from our federally-administered lands and protect other values for which these lands are required by law to be managed. Our members throughout the country have worked for years -- and continue to work -- to protect significant roadless areas as wilderness, to protect wildlife values, fisheries and clean water sources. We believe that the maintenance of a healthy timber industry is compatible with our goal of sound forest management. We recognize that the timber industry has been hit very hard by the current recession and believe that the revival of the timber and building industries must be an important element in the recovery of the economy as a whole. At present, our members are working closely with Forest Service personnel throughout the country on individual forest plans to encourage a move away from cutting timber on lands which are economically or biologically unsuitable for timber production. Thus we are examining the legislation under discussion today by asking two fundamental questions. First, will this legislation help timber companies deal with problems related to the current economic climate? And second, how will this legislation affect sound long-term multiple-use management to our federally-administered forests?

With certain clarifications and qualifications, we view the legislation which has been introduced as relatively neutral from an environmental point of view. However, various legislative ideas designed to help the timber industry recover from the present recession have been circulating on the Hill for several months, some of which have contained provisions which could be extremely damaging to the environment. Rather than confine my remarks entirely to S. 2805, I would like to address the broader question of timber industry relief legislation and touch on provisions which are not actually part of the three bills which have been introduced (S. 2805, S. 2818, and H.R. 6913) but which were included in earlier draft proposals, and the themes of which will undoubtedly be raised again.

The federal government has already taken steps to help alleviate the economic plight of the industry; both the Department of Agriculture and the Department of Interior have adopted extension policies for companies with federal timber contracts. The agencies already have that authority.

Thus, we do not see an obvious need for Congress to pass legislation regarding contract extensions; the language in Section 2 (2) of S. 2805, providing for an extension of up to 5 years beyond the original termination dates of contracts, appears unnecessary. Similar language is included in S. 2818 which goes on to make it clear that penalties would not apply to terminated contracts.

We do not oppose the language in S. 2805 permitting outright termination of an unspecified portion of timber sales contracts. We believe that the language in Section 2 of the bill requiring a showing of economic hardship before contract modifications of any kind are permitted is a sound idea, since the federal government must enforce the concept that a contract should be fufilled except in truly dire circumstances.

We do feel that legislative language permitting contract termination should be refined by adding a provision requiring that the <u>same</u> sales that are terminated be re-offered and sold again before any new sales are offered in roadless lands. Such a prioritization policy would have the

effect of reducing conflicts between logging activities and the protection of roadless areas. It would also give congressional delegations a greater opportunity to consider national forest wilderness legislation. And it makes economic sense since all the work to prepare for these sales has already been completed.

With the inclusion of such language requiring the re-offering of terminated sales before new sales were offered, we do not oppose legislation permitting contract terminations. This is a legitimate method to help timber firms with federal timber sale contracts get through the recession.

We are, however, very concerned at the language of Section 2(3) of S. 2805 which would permit modification of the purchase price of timber sold to reflect present market values for contracts that are not extended. Administratively reducing the prices of timber sales contracts would, in effect, reward companies that speculated on high priced timber during the past several years and, by the same token, would penalize companies which had not overbid on contracts. We believe that, if the Secretaries of Agriculture and Interior were authorized to lower the purchase price for timber sales, there would in fact be very few terminations. As in the case of contract extensions, we believe that outright termination and the later re-offering of the same contracts that are terminated is a much preferable policy, allowing the market mechanism to determine the price. At the very least, if the "roll-back" idea is adopted, a base price should be set to guarantee that costs for site rehabilitation, reforestation and new sales preparation work can be accomplished.

There are several other provisions which, though not included in any of the bills which have been introduced so far, deserve comment because they have been integral parts of debates over the past few months concerning what the elements of timber industry relief legislation should properly be. I want to mention three such ideas now, none of which our organizations believe are related to the current recession and any or all of which we will oppose if they come under active consideration by Congress.

First, some drafts of timber industry relief legislation have contained language which would allow the conversion of "ineffective" purchaser road credits into "effective" credits. This would mean that timber companies would be given credit for road costs in excess of the price of a timber sale. Such a policy would inevitably result in a dramatic increase in bidding for deficit sales, since they would now have a value beyond that of the timber offered. There would be no constraints on timber harvesting due to costs of road construction, and the Forest Service would get into situations in which it would actually have to pay to have timber cut instead of being guaranteed a minimum price. This proposal would thus add to federal deficits.

Another notion which appears in several drafts of relief legislation would permit purchaser road credits to be transferred from one national forest to another, an idea which would benefit large companies with contracts in different regions. The companies would be able to credit the costs of deficit sales in one region against revenues from profitable sales elsewhere in the national forest system. Again, this idea has nothing to do with the current recession and would create incentives to cut timber on unsuitable lands. Both of these issues have been analyzed in a recent Congressional Research Service Report dated June 2, 1982 by Robert E. Wolf. I request that this report be made a formal part of the hearing record.

Finally, earlier drafts of relief legislation have contemplated granting authority to the administering agencies to require a purchaser to perform all or any portion of road construction in terminated sales. Such a policy would set the stage to offer new sales in roadless lands, "leapfrogging" over terminated sales and unnecessarily jeopardizing roadless lands.

Mr. Chairman, in summary, the Sierra Club and the National Audubon Society do not oppose legislation which simply allows for the termination of federal timber sales contracts. But such legislation should require the resale of terminated contracts first and should not become encumbered with non-recession-related issues such as road credit conversions or transferability.

STATEMENT OF

THE NATIONAL ASSSOCIATION OF COUNTIES

The National Association of Counties (NACo)* appreciates this opportunity to present its views on the legislation before you to provide contractual relief to the economically depressed forest products industry.

First, we would like to talk about how the serious crisis in the timber economy has impacted western counties. Specifically, those counties with national forests which are heavily dependent on the timber activities in those forests for timber revenues and employment. The situation is near catastrophic - for those communities, the states, the schools, public services, and the unemployed. In Oregon, as well as other western states, the situation has affected all segments of the economic, political, and social structure.

The counties are the direct beneficiaries when federal timber is sold. While they may not be actual parties to the contracts between the operators and U.S. Forest Service, it can be strongly argued that they hold a vested right in those contracts. And counties have to bear the economic consequences of those contracts. Understandably, the harvest, management and long-term policies on the national forests are of great importance to counties.

---

* The National Association of Counties is the only national organization representing county government in the United States. Through its membership urban, suburban, and rural counties join together to build effective, responsible county government. The goals of the organization are to:

- improve county government;
- serve as the national spokesman for county government;
- act as a liaison between the nation's counties and other levels of government; and
- achieve public understanding of the role of counties in the federal system.

By federal law, 25 percent of the gross national forest receipts to the counties in which the forests are located are to be used for schools and roads. These funds are only generated when timber is cut and removed from the national forests by contract holders. Because of the current economic conditions a large percentage of timber under contract cannot be harvested, and national forest receipt are going to be drastically reduced. For example, on the west side of Region 6, 82 percent of sold standing timber cannot be harvested economically. On the east side, 39 percent can't be cut economically.

The U.S. Forest Service has provided us with estimated receipts for 1982. However, these are their March 31, 1982, estimates, and they will shortly come out with new ones which we believe will be down even further from 1981. Montana receipts for 1982 will be down 36 percent from 1981; Idaho 34 percent; California 50 percent; and Arizona 46 percent. The March predictions point to a reduction of 37 percent for Oregon, but the Association of Oregon Counties has already estimated a 50 percent drop.

These losses do not fall equally among counties. For example, while estimates for Washington only point to an 8 percent reduction, receipts for the Okanogan National Forest are down 68 percent. Shoshone County, Idaho, has already suffered a 30 percent reduction. In many counties, these receipts are a large part of county budgets.

Because counties nationwide are struggling with reduced budgets, the impact of this disruption could be crippling, and will be felt far beyond the schools and roads. Counties cannot make up the shortfalls from timber receipts by increasing tax levies, especially where the economy is depressed and unemployment is so high.

County officials in Oregon, Idaho, Wyoming, and Montana, for example, have all emphasized the near impossibility of raising revenues through taxes. Idaho has imposed a revenue tax freeze since 1978 with the One Percent Initiative; Wyoming and Montana have an overall

limitation on county mill levies. Oregon has a 6 percent limitation on local budget increases.

The impact of reduced timber receipts will further force counties to lay off or furlough more employees and cut back even more essential services. For example, in Oregon, most of the timber counties have been forced already to reduce their work force by an average of 30 percent, and in many cases are only open for business four days a week. Oregon has also reported that 36 school districts may not have the money to open their doors next year.

In addition to increasing layoffs by counties, unemployment in the forest products industry throughout the west is at near record levels, or about 30-34 percent in the region. In many counties the sawmill is the most important or single employer. Aside from the stark human tragedy this situation creates, counties must increase services to help these individuals and their families, and many counties simply don't have the resources.

In Oregon, nine months ago 17,000 workers were unemployed because of the timber slump. Today 25,000 have no jobs. There are 210 mills and timber complexes under normal conditions. Right now 74 are shut down or severely curtailed.

In Washington, 20,218 people are normally employed in 170 mills. 6,800 workers and 61 mills have been affected.

Idaho has been suffering a depression in both its timber and mining industries. Ten counties in Idaho employ the majority of 9,400 forest products workers, 3,100 of whom have been affected. And out of 74 mills, 26 have been closed or curtailed.

These alarming statistics are just three examples. And they only describe the sawmills. They do not even take into account the other areas of the forest products industry, all of which have been affected.

Clearly market conditions have not improved and, as we all know, are getting worse. Economic conditions could create a potential default situation of an enormous dimension. Many small and medium sized companies are on the verge of bankcruptcy, and others have already gone under. In the west, these companies are dependent on the national forests for their timber. Large scale defaults would be disastrous for the counties, as well as all other segments of society.

Because the situation is so complex, existing administrative authority has not been sufficient to provide an adequate remedy. Legislation is necessary to provide more authority - authority directed towards relieving the presert crisis. Without some kind of relief, a large segment of the west's economy may not ever recover.

Oregon, Washington, and California have each passed legislation to modify timber sales contracts on their state forests. The legislation before this Subcommittee has provisions similar to those in the state bills.

Federal legislation is appropriate because the federal government is so closely tied to industry in a contractual relationship, in which the counties also directly participate.

NACo is generally supportive of the legislation. We feel it is based on simple logic and understanding of the problems. Regardless of the reasons, contracts entered into at different times are not operable in today's economy, and will not be activated. The trees covered by thousands of contracts will not be cut. Additionally, we feel that to enforce the terms of the contracts, especially upon the small and medium-sized operations, will force many into bankruptcy.

We support contract price adjustments to reflect today's market conditions and to remove the threat of potentially fatal economic pressures.

However, we do have reservations about other aspects of the bill.

We do not see any need for an extension of 5 years as is proposed. The Forest Service already has authority to grant extensions in the public interest. Last November they granted a second set of extensions that will run into 1985. We do not feel a further five year extension would help the immediate situation, and may delay even further the harvesting of timber.

Further, we are troubled by the term "economic hardship." We believe the legislation should precisely define the criteria, perhaps using the federal banckruptcy statute as a guide. As written now, the term is far too broad and subject to misapplication. We feel it should be spelled out in the bill and not left only to regulations.

We also feel there should be a penalty for contract termination. We recognize that the default provisions in existing law are onerous in the present crisis, and would only serve to force operators out of business. No one wants that result. However, companies should be liable for some form of damages. We recommend that the legislation include forfeiture of the bond the operator put up with the bid, and the operator should reimburse the government's costs on reissuing the sale as well as a percentage of the difference between the previous and new sale levels. Termination without any penalty is not justifiable

We also feel that the Government should consult with the affected county before terminating a contract. The interest of the county as a third party is as strong as the two parties to the contract.

Finally, we urge that careful attention to making the modifications apply with equal impact to all contract holders in all regions, both in the fir belt and in the pine regions of the inland states. The legislation should apply equally to all federally managed forests.

Before concluding, we want to comment on a proposal that had been under consideration during the last months but, wisely, did not become part of the legislation before you. This is the provision permitting companies to transfer purchaser credits from one national forest to another, including "ineffective" purchaser credits.

We would strongly oppose adding this provision to the current bills. This issue is not related to the current recession, and would in no way relieve it. In fact, it would increase federal deficits by substantially adding to Forest Service costs.

This provision would not help those companies on the verge of bankcruptcy, most of whom do not operate in other regions. It would exacerbate their situation by creating unfair competition.

Finally, we feel this provision would have a most detrimental impact on counties.

STATEMENT OF DARRELL H. SCHROEDER
PRESIDENT, MILLER REDWOOD COMPANY

Mr. Chairman, members of the Committee, I am Darrell H. Schroeder, President of Miller Redwood Company of Crescent City, California, a wholly-owned subsidiary of Stimson Lumber Company, Portland, Oregon of which I am also President. Our companies rely to a large extent upon the purchase of public timber as a source of raw material for our lumber, veneer, plywood and hardboard operations in Oregon and California. In this regard we have historically been active bidders on federal timber sales.

While all of us in the timber industry are being adversely affected by the economic conditions which exist today, we believe that the approach to relief being proposed in S.2805 is unfair and aimed at bailing out only a few of the companies in our industry. The low demand for timber products adversely affects all companies in the industry. Permitting selective federal timber contract terminations, however, benefits only a few companies.

Specifically, our major objection to S.2805 is to the proposal which would allow an individual operator to unilaterally terminate some, but not all, of its timber contracts with the federal government. While we agree that there is some merit to a contract termination approach to help the industry, the notion of allowing individual companies to pick and choose the contracts they want to turn back to the government is inequitable as favoring only a select group and not conducive to an industry-wide solution. It must be kept in mind that it is not solely the economy which has caused the problems now confronting the timber industry. Rather, it is a combination of several factors, the most important of which include speculative bidding excesses and hoarding of timber sales which some companies in the Pacific Northwest have engaged in over the past several years. Allowing those companies which obtained federal timber cutting contracts by engaging in irresponsible and excessive bidding to excuse themselves from performance under those contracts because they now deem the price they paid to be too high, is to penalize companies which have traditionally practiced prudent management and refused to become burdened with excessively high cost lumber or which chose

to fulfill their obligations by living up to the terms of all their timber contracts with the federal government, whether they liked it or not. If there is to be any contract termination permitted, then in fairness and equity a company seeking such relief should be required to have all its outstanding timber contracts with that particular federal agency terminated. Otherwise, the timber relief legislation, as envisioned by S.2805, becomes nothing more than special interest legislation favoring only a small segment of the timber industry. S.2805, as drafted, does not address itself to providing a permanent solution to the current industry-wide problems. It is designed to provide only temporary relief and, therefore, fails to address a long range solution.

As an alternative to the relief provisions included in S.2805 which were proposed by those few companies which stand to benefit, I would suggest that in order to help prevent a future recurrence of the problems now facing the timber industry because of past excesses, the following approach would do far more to alleviate the chaotic conditions which now exist in our industry; would help curtail a repeat of past industry abuses; and would be more considerate of equity for all concerned, i.e.. counties and local communities as well as the individual operators.

1. A company should have the option to either:
   a. Terminate 100% of its timber contracts with the Forest Service or Bureau of Land Management; or
   b. Have 100% of its contracts extended for a period of years at a uniform stumpage price to be redetermined by the government, taking into account the equity for counties and local communities.
2. Establish complete new bidding procedures as follows:
   a. Maximum three year contracts.
   b. Twenty percent (20%) down-payment upon awarding of contract.
   c. Sealed bids only.
   d. Maximum volume allowed under contract not to exceed two years annual requirements.
   e. Abolish the present purchaser credit policy and establish a policy of pay as you build.

f. Establish discount benefits for early compliance and completion of the contract.

3. Establish a cap on the volume of Forest Service and Bureau of Land Management timber to be sold annually for the next five years in order not to artificially disrupt the market.

The aforementioned procedures, if enacted, would help eliminate the speculative bidding which has characterized the industry in the Pacific Northwest for the past few years and would also tend to discourage hoarding of timber sales. Failure to enact these provisions will only mean that once the temporary measures for relief envisioned in S.2805 no longer work, then the industry will be back to the Congress seeking additional relief.

I urge your adoption of the substitute provisions outlined above.

98-286 O - 82 - 10

STATEMENT OF AARON U. JONES, PRESIDENT, SENECA SAWMILL CO., EUGENE, OREG.

Mr. Chairman, I would like to thank you and the members of the subcommittee for the opportunity to present my views on the legislative relief being considered with regard to outstanding federal timber sale contracts.

There is no need for me to reiterate in detail the terrible conditions that exist in the forest products industry. Other witnesses have done that. The facts are simply that:

- housing starts are down,
- timber harvesting is down,
- employment is down,
- receipts by federal, state and county governments are greatly down as a result.

The situation in my view is as bad or worse as that which existed during the great depression. The effect on governmental receipts is even worse than in the depression because of a dramatic shift toward public timber as a source of raw materials since that time.

As the Forest Service has recently stated, "the current economic situation in major sections of the forest products industry can only be described as depressed". Likewise, as the Chief himself has found, it is in the substantial overriding public interest to act.

In response to this dismal situation, several proposals have been introduced. They are S.2805 and HR 6913 (which essentially provide for the termination of a portion of a company's timber sale contracts and the extension and/or price modification of remaining contracts) and S.2818 (which provides for the adjustment of contract length without penalty for a period of time equal to the original term of the contract (not to exceed 5 years)).

As noted above, the proposed solutions to the general problem are varied. Therefore, at this point Congress must first note that different problems effect various segments of the industry and recognize that while the situation is universally

bad within the industry, a general solution may solve very little.

The Congress should also note that some definitive action must be taken now. Every day that passes in this period of uncertainty causes new and unexpected problems to arise.

I. Suggestions for the Douglas Fir Subregion

In the Douglas Fir subregion, which is comprised of the western portions of the states of Oregon, Washington and Northern California, outstanding timber sales purchased in previous years are economically inoperable both today and for the foreseeable future. This is true because of the extreme imbalance between the high fixed prices*/ at which they were purchased and the depressed values at which the finished lumber products from these sales can be sold. Absent a radical shift in the pace of housing construction (something which does not loom on the horizon) markets for finished wood products threaten to remain anemic far into this decade.

Extension of these contracts would do very little in terms of providing relief to the industry, maintaining the stability of the communities in which mills are located, and generating employment. In fact, merely extending these sales will have a severely negative effect on any number of companies presently up against the financial ropes. The magnitude of the financial crisis facing these firms can be seen in the fact that at prices bid in 1979 the average cost of only a 4 month supply of timber is equal to the average purchaser's present net worth. Since most companies have a two year supply of timber under contract, it is clear that absent relief profound losses will be incurred if these sales were harvested. These tremendous losses are

---

*/ It should be noted that these sales were purchased at flat rates rather than at rates subject to escalation/de-escalation as in other areas.

presently being viewed as liabilities on the companies' balance sheets by banks and bonding companies, among others. Thus, not only is the ability of these companies to borrow the monies necessary to sustain themselves effected but so is their ability to secure the bonding which is vital to continued operations. Absent immediate termination of these sales the very existence of these companies is in extreme jeopardy as is the existence of the industry as it presently exists in the Douglas Fir subregion.

Moreover, granting further extensions does not add to present employment or harvesting levels especially when the sole reason for granting extensions lies in the hope that the market for finished products will soon return to reasonable levels so as to make the sales economically harvestable. Rather, based on this premise it would be difficult to deny additional non-productive extensions should the hoped for return of the market not occur.

Accordingly, extensions will also have a serious negative effect on the ability of the government to manage its timber lands in the sense that certain of these lands, which silviculturally may become in need of harvesting, will be "locked up" for long periods by contract and thus difficult, if not impossible, to truly manage.

Furthermore, extensions will only give false encouragement to some companies who will as a result return to the practice of bidding for sales at prices beyond the break even point. Their ostensible purposes will be to bring down their average price of timber under contract. However, by doing so the only things that will happen are that average stumpage prices will rise while timber volume encompassed by economically inoperable sales will increase.

The only solution that is viable in the Douglas Fir subregion is to

(1) grant each purchaser the right to terminate any and all sales in the subregion just as Congress did back in 1935 when blanket terminations were legislated
(2) require that each purchaser pay for the cost of

reselling the timber sale so terminated (up to $10,000 per sale)

(3) require that any sale not terminated be operated as required by contract without any further "emergency type" modifications or extensions.

(a.) Additional antispeculative measures

In my view, terminating and then reselling timber sales in conjuntion with a reasonable allowable cut would assure adequate supplies of raw materials at reasonable prices (something which is necessary to preclude the present situation in the Douglas Fir subregion from arising again). However, additional care should be taken to preclude any future return to runaway bid prices should the market show some signs of recovery.

I recognize that the Forest Service and BLM have made and are contemplating making other steps in this regard. However, I would also suggest the implimentation of measures which would permit only responsible bidders to participate in oral auctions. (Please note, I am not suggesting the use of blanket prequalification as this could have a negative impact on a new entry into the industry. However, I am saying that a determination of the responsibility of all participating companies should be made before the oral auction phase of competition so that the competition thereafter is only between bonafide bidders. I am advised by counsel that such an approach is both entirely feasible and consistent with all competitive bidding requirements.)

In addition, as another antispeculative measure, I would suggest that there be a repeal of all regulations that permit or encourage nonresponsible bidders to bid up timber sales with impunity. In this regard, I would commend the subcommittee's attention to Forest Service regulation 36 CFR §223.7(c) which permits any company to drive up the price for timber at oral auction, thereafter be found nonresponsible and inelegible for award at which time "award at the highest price bid may be offered to the next highest qualified bidder". In this and related circumstances, I would suggest a return to the previously

98-286 O - 82 - 11

used rule whereunder, all bids received from any concern which is later disqualified for award were stricken from the record and award was made to the qualified bidder which submitted the highest bid, at its first bid which exceeded other bids from qualified concerns.

Consideration should also be given to raising cash deposits payable at the time of contract execution from the present 5% of bid price to a higher level, on a subregion by subregion basis, whenever it appears that the average bid price within a subregion greatly exceeds the average appraised price within that subregion. This will apply antispeculative pressures where, when and if needed but only where, when and if needed and should not unduly burden other geographic areas with the solutions to problems that are unique to a particular subregion.

In this regard, I would favor a formula such as this:

Difference between average bid price & average appraised price (i.e., average over bid)	Cash Deposit
0 -25%	5%
26%-50%	10%
51%-75%	15%
76%-	20%

II. Basic Relief for Other Regions

The problem within the industry that exists in regions other than the Douglas Fir subregion is significantly different. Outstanding federal timber sales in other regions may not be permanently inoperable. This is true because these sales unlike these in the Douglas Fir subregion were not bought at excessive flat rate prices and the sale prices were subject to escalation/de-escalation based on market conditions. Indeed, to date, stumpage prices for this timber have de-escalated on the average of $100 per thousand board feet.

However, this is not to say that there may not be instances in which termination is entirely appropriate and that, as such, granting purchasers a right of termination in these areas is not

only fair but also a necessary option. Nevertheless, the fact remains that these timber sales do not need anywhere near the level of recovery of the finished products market to become operable that the sales in the Douglas Fir subregion require. As such, if the holders of these sales were simply afforded the opportunity to request and receive additional time in the form of contract term adjustments made without penalty or payment, operability problems that currently exist with the sales may be worked out. In this regard, the suggestion in S.2818 for contract term adjustment equal to the length of the original term of the contract (not to exceed 5 years) would appear to be a particularly effective one where within the adjusted term the sales would be operable. Relief of this sort, as an adjunct to a right to termination, would seem entirely appropriate in regions other than the Douglas Fir subregion with its unique problems.

III. Scope of Relief

At this juncture some discussion as to the scope of proposed relief may be in order. S.2805 and HR 6913 as presently written would afford relief but would limit that relief to those companies which could make "a showing of economic hardship."

Even as the president of a company that is very small in comparison to the giants which exist in our industry, I cannot favor this limitation. Our entire industry is in trouble. The facts, stated broadly at the outset of my remarks and those raised by others in their presentations to the Committee, clearly indicate that we are an industry in distress. However, the present legislation smacks of the analogy that the ship has gone down, and lifeboats are picking up survivors with the admonition to "take one and leave one!"

Any attempt at this time to discriminate between companies on the basis of need will, in my view, ultimately lead only to unfairness, inequity and finally to litigation. It is far better

that a few companies get relief which might not be critical to their ultimate survival than for a single company to be denied relief that is in fact critical to its survival simply because that company did not fall within some arbitrary definition of economic distress.

It is for not unanalogous reasons that the partial nature of the termination authorized by S.2805 and HR 6913 leads me to conclude that enacting this legislation without modification would again generate unfairness and would not maximize the industry's survival rate. To permit only limited terminations, would disproportionately benefit some multiregional operators to the competitive detriment of the companies, both large and small, which operate solely within the Douglas Fir subregion. That is, a company with federal contracts both within and without the Douglas Fir subregion, if allowed to terminate a sufficient percentage of its volume under contract so as to liquidate all its high priced holdings in the Douglas Fir subregion would have gotten rid of the entire millstone that permanently inoperable sales represent. At the same time, a company operating sales solely within the Douglas Fir subregion, even if allowed to terminate the same percentage of its contractual holdings, would still be saddled with a monumental potential liability in the form of its remaining high priced sales to the point where the competitiveness of that company if not its continued existence would be seriously jeopardized.

As I said earlier, in my view no company in this time of general distress within our industry should be denied relief solely by virtue of its size or structure. Likewise, I feel that no company by virture of its size or structure should be allowed to benefit unduly from such legislation. Rather the legislative aim should be to return stability to the timber industry while at the same time not disturb the balance that has existed within the industry in recent years.

IV. The "Cost" of Relief

Some would have the Congress believe that the relief being discussed will amount to a huge reduction of assured receipts to the federal treasury.

I would hope to have you recognize that relief can be justified solely on dollars and cents grounds and that the added human benefit to be derived from such relief is wholly apart and in addition. That is, in order to assess the impact of this legislation the Congress must critically analyze, and not merely accept at face value, the alleged amount and assuredness of the receipts which would be foregone if these timber sales were terminated.

By calculating the total current contract value of sales which would be terminated, less the total actual value that would be obtained from resale, a figure can and has been determined. However, whether this figure is anywhere near the actual amount of foregone receipts is dependent on one very salient factor--Could the federal government recoup this amount of money from purchasers if no relief were granted? The answer to that question is, in my opinion, clearly no.

As stated by the Forest Service in its report on implications of timber sale termination legislation, "if economic conditions do not improve and the high price sales are defaulted, the only receipts will be through collection of damages and any resale value. If many operators go bankrupt it will not be possible to make a full collection of damages even though there are sureties with each contract. Sureties are liable for a maximum of 10% of the contract value."

This can best be seen in the following example -

1) absent relief the purchaser, heavily in debt, suspends operations.
2) the timber sales expire uncompleted
3) banks & other mortgage holders assert their clear rights to the company's tangible assets (plant & equipment) (specified assets will be disposed of to meet the claims of these creditors)

4) bonding companies establish their position to specified assets and monies based on indemnity agreement with the company (specified assets will be disposed of to meet the claims of these creditors)
5) other secured creditors assert their rights to other tangible and intangible assets (specified assets will be disposed of to satisfy the claims of these creditors)
6) general unsecured creditors assert their claims
7) the company is probably put into involuntary bankruptcy proceeding by unsecured creditors
8) the timber sale is resold for much less than price under the original contract
9) the government attempts to collect the difference from the defunct company
10) the government sends a bill to the surety for the limited portion of damages covered by bond (Note sureties are liable for maximum of 10% of contract value)
11) the surety and/or referee in bankruptcy contest liability and assert any and all defenses of the defunct company
12) the matter is litigated for several years
13) if the government wins, the surety pays its percentage and the government, as another unsecured creditor, is paid only if there are unencumbered assets remaining (but then only on a percentage basis. Normally .05-20 on the dollar)
14) if the government looses - the government gets nothing

While this has gone on

- one less company exists in the industry
- one more step toward concentration has occurred
- competition is decreased
- the physical productive capacity represented by the company is lost forever
- the company's employees stop paying income taxes, social security taxes, etc.
- the government has to pay unemployment, and possibly welfare to the former employees
- the local tax base has decreased as the facility goes off the tax rolls

Moreover, it should be noted that even if some minor continuing effort to harvest these "unharvestable" sales were possible, to the extent that the federal treasury receives revenues from these sales, these receipts are being offset by significant corporate losses which, under the tax laws, permit the corporations to receive refunds of taxes paid in previous profitable years.

Based on the above and the fact that passage of appropriate relief will insure the existence of future competition and thus a reasonable level of federal receipts from timber sales, I feel that the government will in the long run make money from this legislation. This is especially true when one also considers

that we are dealing with a live growing product, a tree, which is increasing in wood volume at 2% a year.

V. Market Shifts

Lastly, there are those who will urge the Congress not to adopt relief along the lines suggested herein and in part in S.2805 and HR 6913 for fear that such relief will permit timber products from the Douglas Fir subregion to invade retail markets traditionally dominated by other regions of the country. To these individuals, I would say that such a situation is not possible in view of the significant distance and freight rate differential which greatly work to the disadvantage of the operators in the Douglas Fir subregion and as such preclude the practical expansion of that region's markets for finished products. Moreover, the market invasion to be feared comes not from within the United States but indeed from without. That is, at present the Canadian government is substantially underwriting not only timber production but also greatly assisting Canadian companies by virtue of extremely favorable rail rates. As a result, Canadian imports, have reached astronomical levels in areas as far from Canada as the southeastern portion of the United States. For example, I am advised that 55% of the forest products sold in Georgia is Canadian. These imports in fact setting the prices in many retail markets. This unrelenting drive toward lower retail prices due to pressure from Canadian sources coupled with an unfavorable rail rate differential make it clear that Douglas Fir finished products could not successfully compete in anything other than its Western markets even in the unlikely event that the price for raw materials in the Douglas Fir subregion were to drop all the way down to the regulatory minimum base rates.

Mr. Chairman, again I thank you for the opportunity to have addressed this subcommittee.

(The following material was supplied by Steve H. Hanke, professor of applied economics, Johns Hopkins University, see p. 24.)

Some Economic Implications of Federal Timber Contract Legislation

(September 10, 1982)

Introduction

Legislative proposals for the termination and extension of federal timber sales contracts have raised a number of general questions about the economic effects that such legislation might have. These questions include the implications for bidding practices for federal timber if a precedent of providing contract relief is established; equity considerations regarding other economically distressed industries; competition among regional timber markets; impacts on federal timber management programs; and the effects of termination on revenue-sharing programs (in lieu payments) for local governments.

Specific attention has also focussed on the impact that termination might have on the flow of revenues to the U. S. Treasury. This latter issue is the subject of the present report. It is analyzed here because an important aspect of this question appears not to have been considered. If buyers of federal timber are relieved of their contractual obligations, then Treasury will experience some revenue losses. It can, however, also expect some gains. Gains would be expected because adjustments would likely have to be made on past taxes paid on timber harvest income. These adjustments would require that firms in the timber industry pay additional taxes.

The magnitudes of the expected revenue losses to Treasury are uncertain for a number of reasons, including the difficulties of estimating which contracts will be terminated and which will be extended, the costs of reselling terminated timber, and the prices at which it will be resold. In spite of these difficulties, both the Department of Agriculture and the Library of Congress have developed estimates of the potential costs to Treasury of legislation to provide timber contract relief to the timber

industry. These estimates range from $1.3 to $2.0 billions (Wolf, 1982).

The assumptions most commonly used in developing these loss estimates are that 40 percent of the volume of federal timber under contract could be returned to the selling agency, either the Forest Service or the Bureau of Land Management (BLM), and that remaining contracts would be extended for five years. Contract extensions are effectively interest free loans on accounts receivable. The assumptions of 40 percent terminations and 5-year contract extensions have been incorporated into the present analysis.

The mechanism which gives rise to potential revenue gains for Treasury as a result of timber contract termination is the differential tax rate between ordinary income (48 percent) and capital gains (30 percent prior to 1981 and now 28 percent). In preparing their tax returns, firms in the timber industry have commonly used bid prices for federal timber sales as evidence of fair market value. Fair market value is defined by the IRS as a "cash equivalent" or "spot" price. Bid prices are "futures" or "forward" prices. They are not cash equivalents.

In general, the higher the fair market value that is assigned to timber, then the less federal taxes a firm must pay. A tax savings of $0.18 results ($1.00 x (0.48 - 0.30)) for every dollar of profits shifted from ordinary income to capital gains. Exceptions to this savings occur if a timber company has "excess" capital gains. This situation can arise if a firm is harvesting timber which it acquired at low prices in the past. Tax burdens may be minimized by exercising the option to pay ordinary income taxes rather than capital gains. The latter situation is relatively uncommon. It has not, therefore, been considered in the present analysis.

Assuming that speculative bid prices during the period 1977-1980 were higher than fair market value, as timber industry officials now appear to be conceding, then this means that tax

payments made by the timber industry during these same years was less than they otherwise would have been.

The estimate of the net effect of federal timber sale contract termination on Treasury which is developed here is the estimated cost of termination minus the estimated tax "exposure" of the timber industry. The latter estimate is based on the assumption that 1977-1980 bid prices for federal timber would be rendered inadmissible as estimates of fair market value for tax purposes by legislation which would terminate and extend federal timber sales contracts. Fair market values for timber for these years are developed, and then a "revised" schedule of tax payments is estimated.

Since western Oregon and western Washington, and California, are most seriously impacted by high-priced federal timber contracts, and most financial effects will occur there, the analysis is restricted to these regions. Additionally, relevant data are more readily available for these states.

Background

According to Forest Service Timber Sale Contract Provision B9.4 (Failure to Cut): "Damages due the United States for Purchaser's failure to cut and remove such timber meeting Utilization Standards shall be the amount by which Current Contract Value plus the cost of resale, less any effective Purchaser Credit remaining at the time of termination, exceeds the resale value at new Bid Rates."

Purchaser credit is the value of road construction work which has been completed by timber buyers. They are paid for this work with national forest timber. For example, if a timber buyer is allowed $500,000 in purchaser credits for building road in conjuntion with a national forest timber sale, then he is entitled to $500,000 worth of timber. The value of the timber is based on effective timber prices that the buyer is committed to pay.

Selected statistics for federal timber sales are shown in

Table 1, including quantities of timber sold, average bid prices, and volumes of timber under contract. (See Ruderman (1981).) Both Forest Service and BLM timber sales are shown. The data are also separated by region; Forest Service data into two regions, Oregon and Washington, and California; BLM data are for Oregon. The BLM manages very little timber in Washington and California.

Table 1: Selected Federal Timber Sales Statistics for Oregon, Washington, and California, 1977-1980.

Year	Quan. Sold (bill. bd. ft.)	Avg. Bid Price ($/MBF)	Vol. Under Contract (bill. bd. ft.)
	Forest Service Sales in Oregon and Washington		
1977	4.7	139.73	11.6
1978	4.8	181.49	12.5
1979	5.4	251.12	13.0
1980	5.4	254.06	14.5
	Forest Service Sales in California		
1977	1.7	118.14	4.9
1978	2.0	145.57	5.1
1979	2.1	201.08	5.2
1980	1.9	241.39	5.8
	BLM Sales in Oregon		
1977	1.2	180.82	2.1
1978	1.2	196.36	2.2
1979	1.1	292.59	2.2
1980	1.1	323.63	2.5

Cost of Contract Terminations

Based on the assumption that 40 percent of the federal timber sales contracts will be terminated, and that contract holders will terminate those contracts for which they are committed to pay the highest prices, then the following estimates for gross losses to the Treasury can be developed from Table 1:

A. Forest Service Contracts in Oregon and Washington:

1. 0.40 X 14.5 billion bd. ft. = 5.8 billion bd. ft.
2. 5.4 bill. bd. ft. X $254.06/M = $1.372 billions
3. 0.4 " " " " 251.12/M = 0.100 "

5.8 " " " " 253.86/M = $1.472 "

B. Forest Service Contracts in California:

1. 0.40 X 5.8 billion bd. ft. = 2.3 billion bd. ft.
2. 1.9 bill. bd. ft. X $241.39/M = $0.459 billions
3. 0.4 " " " " 201.08/M = 0.080 "

2.3 " " " " 234.38/M = $0.539 "

C. BLM Contracts in Oregon:

1. 0.40 X 2.5 billion bd. ft. = 1.0 billion bd. ft.
2. 1.0 bill. bd. ft. X $323.63/M = $0.324 billions

1.0 " " " " $323.63/M = $0.324 "

Totals: 9.1 bill. bd. ft. X $256.60/M = $2.335 billions

The $2.335 millions estimate derived from the above calculations is an estimate of gross losses to Treasury of terminating 40 percent of the federal timber sales contracts in Oregon, Washington, and California. To estimate net losses an adjustment must be made for the resale value of timber and for purchaser road credits. Current market prices for federal timber, and informed opinion about reselling costs and purchaser road credits suggest that the following assumptions are reasonable for making this adjustment: reselling costs, $10 per MBF; resale price, $100 per MBF; and value of purchaser road credits, $100 millions.

Based on these assumptions the gross estimate developed above must be reduced by $719 millions. This adjustment results in a net cost of termination of $1.616 billions.

Cost of Contract Extensions

Contract extensions result in a deferral of timber sales receipts to Treasury, hence the cost of extensions is the difference in the present net worth of existing contracts less the present net worth of the after their performance period has been extended.

Timber sales data are difficult to obtain which would permit the development of an accurate estimate of what the cost of contract extensions would be expected to be. A crude estimate can be developed, however, from data which have been included in a report made about the forest products industry by the securities firm, Merrill Lynch (1982). These data are shown in Table 2.

They indicate volumes of Douglas fir timber under contract from the Forest Service in western Oregon and western Washington, the prices at which this timber is under contract, and the periods of the contracts. If it is assumed that the timber listed in Table 2 is distributed proportionately throughout Forest Service contracts in western Oregon and western Washington which are listed in Table 1, then contract extensions would apply to contracts which buyers still held after they had returned 40 percent of their timber volume under contract to selling agencies. It is reasonable to assume that contracts which contain the highest priced timber would be returned first.

Allowances to estimates developed under these assumptions from the data in Table 2 would then be required to account for contract price differentials if timber species other than Douglas fir are included, and for BLM timber sales and Forest Service sales in eastern Oregon and eastern Washington and in California. These allowances are made after estimates are made of the cost of contract extensions for only those data shown in Table 2.

If 40 percent of the highest-value timber is eliminated from the listing shown in Table 2, then items C, D, and G would be dropped. These items represent timber which would be included in contracts which would be terminated. They sum to slightly more

than 40 percent of the timber shown in Table 2 (40.2 percent), but this difference is negligible and is, therefore, ignored.

The assumptions on which the calculations for estimating the costs of five-year contract extensions are based are:

1. All present net worth calculations are brought to July 1, 1982.

2. The discount rate is 10 percent.

3. The number of seasons during which each contract will be logged (harvested) is equal to, or less than two.

4. The logging season, on the average, ends October 31 of each year. (Note: The reason that contracts end on March 31, 5 months later, is because the necessary paperwork for arranging a contract extension can be completed during the winter months when, typically, because of weather conditions logging is not feasible.)

5. The rate of timber harvest is a constant and is equal to total contract volume divided by the numer of years during which harvest is expected to take place.

Table 2: Inventory of Forest Service Douglas Fir Timber Under Contract in Western Oregon and Western Washington (Westside, Region 6) as of 3-31-82:

Item	Contract Exp. Date	Volume (MMBF)	Bid Price ($/MBF)	Value ($mill)
A.	4-1-82 to 3-31-83	1,782.41	294.39	524.7
B.	4-1-83 to 3-31-84	2,133.51	347.05	740.4
C.	4-1-84 to 3-31-85	1,873.20	383.09	717.6
D.	4-1-85 to 3-31-86	1,042.71	404.31	421.6
E.	4-1-86 to 3-31-87	365.23	338.22	123.5
F.	4-1-87 to 3-31-88	117.91	354.35	41.8
G.	4-1-88	50.00	533.00	26.6
		7,364.97	352.52	2,596.3

Source: Merrill Lynch (1982).

Table 3: Current Contract Termination Periods, Period of Termination if Extensions Granted, and Effective Period For Logging

Item	Current Contract Dates	Eff. Log. Period	Extended Contract Dates	Ext. Log. Period
A	4-1-82 to 3-31-83	4 mos	4-1-87 to 3-31-88	19 mos
B	4-1-83 to 3-31-84	16 "	4-1-88 to 3-31-89	19 "
E	4-1-86 to 3-31-87	19 "	4-1-91 to 3-31-92	19 "
F	4-1-87 to 3-31-88	19 "	4-1-92 to 3-31-83	19 "

Other information for Items A, B, E, and F in Table 3 are the same as listed in Table 2. The effective logging period is the period during which cash flows are being generated. The 4 months for Item A, for example, is July 1, 1982 to October 31, 1982. As noted in the assumptions, all cash flows are discounted to July 1, 1982. Cash flows are assumed to discontinue on October 31, 1982, even though contracts under Item A do not expire until March 31, 1983, because of the seasonality of logging operations.

The 19 months effective logging period for item A, under the heading of "Extended Contract Dates," is the period during which cash flows are assumed to occur if contracts are extended. For the sake of simplicity in discounting cash flows, payments are assumed to occur uniformly over this period.

The 16 months under item B is the period from July 1, 1982 to October 31, 1983 when the last logging season in the contract ends.

A. Calculations for Item A:

1. Present net worth (PNW) of complying with existing contracts. Cash flows occur July 1, 1982 to October 31, 1982, 1/3 of a year.

$$PNW = (\$294.39/M)*(1{,}782.41MM)/(1/3\ yrs.))*((1-e^{-1/3i})/i))$$

PNW = $515.6 millions

2. Present net worth of cash flows which are assumed if contracts are extended. Cash flows are delayed from July 1, 1982 to April 1, 1986 (3.75 years), and are generated from April 1, 1986 to October 31, 1987, a period of 19 months (19/12 years).

PNW = (($294.39)*(1,782.41/(19/12 yrs.))*

$$((1 - e^{-(19/12)i})/i)*(e^{-3.75i}))$$

PNW = $334 millions

3. Loss on Item A = ($516 - $334) millions

= $182 millions

B. Calculations for Item B:

1. Present net worth of complying with existing complying with existing contracts. Cash flows occur July 1, 1982 to October 31, 1983 (16 months).

PNW = ($347.05)*(2133.51/(16/12))*$((1 - e^{-(16/12)i})/i)$

= $693 millions

2. Present net worth if contracts extended. Cash flows are delayed from July 1, 1982 to April 1, 1987 (4.75 years), and occur from April 1, 1987 to October 31, 1988 (19 months).

PNW = (($347.05)*(2133.51/(19/12))*

$$((1 - e^{-(19/12)i})/i)*(e^{-4.75i}))$$

PNW = $468 millions

3. Loss on Item B = ($693 - $468) millions

= $225 millions

C. Calculations for Item E:

1. Present net worth of complying with existing contracts. Cash flows delayed from July 1, 1982 to April 1, 1985 (2.75 years), and occur from April 1, 1985 to October 31, 1986 (19 months).

PNW = (($338.22)*(365.23/(19/12))*$((1 - e^{-(19/12)i})/i)*$

$$(e^{-2.75i}))$$

PNW = $87 millions

2. Present net worth of contracts if extended. Discount above present net worth by 5 more years.

PNW = $86.8*$e^{-5i}$

PNW = $53 millions

3. Loss if extension granted = ($87 - $53) millions

= $34 millions

D. Calculations for Item F:

1. Present net worth of complying with existing contracts. Cash flows are delayed from July 1, 1982 to April 1, 1986 (3.75 years). Cash flows occur April 1, 1986 to October 31, 1987 (19 months).

$$PNW = (\$354.35)*(117.91/(19/12))*((1 - e^{-(19/12)i})/i)*e^{-3.75i}$$

$$= \$27 \text{ millions}$$

2. Present net worth if contracts extended. Discount above present net worth another 5 years.

$$PNW = \$26.6*(e^{-5i})$$

$$= \$16 \text{ millions}$$

3. Loss on Item F = ($27 - $16) millions

= $11 millions

E. Total loss if extensions granted:

Total Loss = ($182 + $225 + $34 + $11) millions

= $452 millions

The estimated cost of $452 millions for contract extensions is, as noted above, for Forest Service sales of Douglas fir in western Oregon and western Washington only. This estimate must be reduced to account for the fact that the average value of all timber species in these contracts will be less than the value of Douglas fir. Secondly, the estimate must be increased to account for Forest Service sales in eastern Oregon, eastern Washington, and California, and BLM sales in Oregon.

Taking the latter first, from Table 1 about 65 percent of the total timber under contract at the end of 1980 which is listed there is Forest Service timber in Oregon and Washington. Most of this is located in the western parts of both states. This means that the contract extension cost developed from Table 2 can be increased by 35 percent to account for other Forest Service sales in the three-state area and BLM sales in Oregon.

Inspection of prices in Tables 1 and 2 suggests that average prices for all species under contract in the three-state area are about 75 percent of Douglas fir bid prices in contracts which will be extended.

The net effect of a 25 percent reduction and a 35 percent increase suggests that a reasonable estimate of the cost of contract extensions is to increase the $452 estimate developed above by 10 percent. This results in an estimate of the cost of

contract extensions of $500 millions. This estimate seems reasonable in view of the amount of timber under contract, its value, and relevant interest charges on deferrals of accounts receivables on values of these magnitudes.

Estimated Income Tax "Exposure"

The estimated income tax "exposure" from federal timber contract termination is calculated in Table 4. Calculations are made for each of the years 1977-1980. This was the period during which speculative bidding for federal timber was most prevalent. The assumptions underlying the calculations made in Table 4 are:

1. Bid prices for federal timber were being used as estimates of the fair market value for tax purposes.

2. Bid prices for timber exceeded fair market value. The difference, or "spread," between bid price and fair market value is a measure of the extent to which buyers were willing to speculate.

3. Bid prices are weighted averages of all public timber sales as as listed in Table 1 above. (Note: In general, high bid prices, rather than averages, are commonly used in preparing tax returns, hence the estimates of bid prices used here will give conservative estimates.)

4. Fair market values (FMV) are determined by discounting bid prices according to expected timing of cash flows, and expected changes in the market price of timber.

5. Capital gains taxes were being paid on 75 percent of the timber being harvested in the three-state area included in the analysis.

6. The gain to taxpayers from paying capital gains taxes rather than ordinary income was $0.18 per dollar.

Table 4: Estimated Income Tax "Exposure"

Year	Tbr. Price ($/MBF) (Bid - FMV)				(0.75) Har. Vol. (MMBF)		.18	=	Apparent Gain ($ millions)
1977	(141	-	75)	X	14,400	X	.18	=	171
1978	(175	-	100)	X	14,800	X	.18	=	200
1979	(244	-	150)	X	15,100	X	.18	=	255
1980	(260	-	175)	X	13,400	X	.18	=	205
							Total		$831

The procedure used in making the calculations in Table 4 is to multiply the difference between bid price and fair market value

by 0.75 of the total volume harvested in Oregon, Washington, and California, and then multiply this result by the $0.18 per dollar tax advantage gained by paying capital gains taxes rather than ordinary income.

Conclusions

As shown in Table 4, the estimated income tax "exposure" of the timber industry, if federal timber sales contracts are terminated and, therefore, bid prices are subsequently rejected as evidence of fair market value, is $831 millions. It should be noted that the issue of using bid prices as evidence of fair market value has been the subject of litigation. Whether or not legislation to terminate federal timber sales contracts might have an effect on court decisions on this practice will be a question of considerable interest within the timber industry if termination legislation is adopted.

Summarizing the various estimates developed above, the net effect of terminating and extending federal timber sales contracts is $1.3 billions (rounded); $1.6 billion loss from termination; $500 millions loss from contract extensions; and an estimated gain of $800 millions from tax "adjustments." While this estimate is admittedly crude, it does incorporate financial effects which federal timber contract legislation could have, and which have not been previously considered.

Literature Cited

Merrill Lynch. 1982. Forest Products Industry: Revision of 1982-1983 Forecast. 20 pp.

Ruderman, Florence K. 1981. Production, Prices, Employment, and Trade in Northwest Forest Industries. U. S. D. A., For. Ser., Pac. N. W. For. & Rge. Expt. Sta. (Published quarterly).

Wolf, Robert E. 1982. Memorandum to Representative Ron Marlenee regarding termination of Forest Service and BLM timber sales contracts. 22 pp. (dated June 2, 1982).

Testimony of Starr W. Reed

Simpson Timber Company

Mr. Chairman and Committee Members:

I am Starr W. Reed, Senior Vice-President, Resource Management, for Simpson Timber Company of Seattle, Washington. This testimony is submitted for the record of the hearing held on August 12. Simpson is a mid-sized forest products company involved in forestry, logging and the manufacture of forest products in Washington, Oregon and California. Simpson produces an average of 350 MMBF of logs for manufacture in its West Coast mills. This harvest and consumption is projected to generate approximately 10,500 jobs including direct employment, contractors and suppliers. My primary responsibilities for Simpson include forest management on Company timberlands and assuring an adequate wood supply for our manufacturing facilities from fee-owned timberlands and from purchases of open-market timber.

Under typical operating conditions, 40 percent of Simpson's wood requirement is obtained on the open market. However, Simpson's Albany, Oregon, plywood plant, which directly employs 210 people, relies exclusively on open-market timber. By far the predominent source of this purchased timber is Forest Service and BLM timber sales.

Much federal timber purchased in Washington, Oregon and California in recent years was sold at prices which greatly exceed the value which can be derived through conversion into forest products in today's market. Economic projections further supported by national policy indicate this situation will prevail for many years. A reasonable solution to the problem of non-economic timber sale contracts is vital to Simpson as it is for many West Coast producers. The future of many West Coast federal timber purchasers, their employees and many rural communities dependent on the forest industry rests on the outcome of this issue.

Relief on timber sale contracts has been labeled by some an "industry bail out." We think this is a particularly unfair and prejudicial accusation. The charge impedes constructive resolution of an extremely difficult problem caused by factors totally beyond industry control and not anticipated by anyone. At the time much federal timber now under contract was bid, the federal government's policy had a very stimulative affect on housing and forest products demand. Forecasts for housing were for at least 2.2 million average annual housing starts for the 80's, with the U. S. Forest Service in its 1979 RPA Assessment projecting 2.6 million average annual housing starts for the decade.

Since 1980, however, federal policy influencing housing has shifted dramatically. Banking deregulation, reduced low-income housing subsidy and tight control of money supply have combined to flatten housing and the domestic demand for wood products. Optimistic forecasts in 1982 indicate housing to average 1.5 million starts for the 80's, a far cry from the 2.6 million average forecast by the Forest Service just three years ago. This lower prospect for housing has caused the demand for and value of timber to plummet. Stumpage now sells for one-third to one-fourth the values bid three years ago.

The Forest Service and the Bureau of Land Management wisely granted extensions on existing timber sales which postponed timber sale contract defaults and severe economic dislocation. Likewise, Washington and Oregon, two states with their own substantial timber sale programs, moved recently to grant timber sale relief. The legislatures of both states, despite their own critical revenue shortfalls and charges of "industry bail outs," after analysis of the dilemma, concluded that the long-term public interest of the states would be best served by granting relief in the form of both timber sale terminations and extensions.

In June, 1982, in response to a Congressional request, Robert E. Wolf, Assistant Chief, Environment and Natural Resources Policy Division, Congressional Research Service, submitted analysis of a timber industry legislative proposal for timber sale contract relief. We feel that analysis contains assumptions and conclusions which grossly overstate the public impacts resulting from the proposal. The forest industry has submitted a critique of Mr. Wolf's analysis which addressed most issues.

We believe it is important, however, to underscore one basic and major flaw in Mr. Wolf's response. The analysis assumes the federal government incurs a cost or a loss of revenue as a result of termination and the reoffering of sales contracts. That assumption is incorrect. The fact is, the timber affected is at a price so high much of it will not be harvested and the Treasury will not receive stumpage payment for it. This will then result in massive defaults creating a complex administrative process and prolonged litigation; none of which will benefit the Treasury, the industry or the public.

The states of Washington and Oregon acted to aid their timber purchasers during this crisis. Likewise, the Forest Service and BLM have done what they could administratively to postpone an economic catastrophe. But the need for contract relief cannot be resolved and an orderly resolution of the dilema achieved until Congress acts. We are pleased that that this Committee recognizes this and has agreed to consider Congressional action.

We have reviewed S. 2805 and H.R. 6913 sponsored by Senator Hatfield and Representative Weaver, respectively. The Bills are based on satisfactory concepts; but in our opinion, they contain two features which require amendment.

1. Section Two requires timber purchasers provide evidence of economic hardship to the Secretary of Agriculture or the Secretary of Interior with their petition for contract modification. We urge that this requirement be deleted and that the rules governing contract modifications be prescribed by law. The burden of deciding who qualifies should not be placed on the Secretaries. Qualification for termination and extension should be limited only by time criteria, the volume to be terminated, and condition of the timber sales. A discretionary approach would lead to extreme administrative problems and unwarranted inequities.

2. Subsection (3) in Section Two, which provides for the modification of the purchase price of timber sold, to reflect current market values, should be deleted. This provision again would result in an enormous administrative problem for federal agencies. In addition, it would create controversy and dispute over what constitutes current values. Even after purchase price modifications, sales may not be economically operable. A better and more equitable solution would be to simply allow the purchaser to request and terminate qualifiying sales and then repackage the sale for reoffer at competitive bid which in turn will reflect market value.

3. If Section 4 means that the authority to process termination of a timber sale expires at the end of one year, we recommend amending this provision to incorporate the following concept:

   Contract holders are to notify the appropriate Secretary as to which sales they wish to terminate or modify the contract term within 60 days following publication of the regulations required by this Act. Completion of the termination process for those sales that qualify for termination under the regulations will not occur earlier than one year prior to the expiration date designated in the timber sale contract.

This type of limitation will require an early decision and commitment, but will provide for both orderly processing of termination requests and the reoffering of the timber volume included in the terminated contract.

As testimony is analyzed, the Committee will surely conclude that more detailed prescriptions are needed to provide clear direction to the Secretaries and to assure equal treatment to all federal timber purchasers. To reach for this, we recommend your study of the draft proposal developed by industry and included in other testimony. A draft copy is attached for reference. This proposal may not be acceptable in total as currently drafted, but it does contain valid and effective provisions relating to contract termination and contract term adjustment.

S. 2518, introduced by Senator McClure, does not provide for contract termination, but it does authorize term adjustments of up to five years at the request of timber sale purchasers. Such adjustments would be limited to sales purchased prior to January 1, 1982, and would be permitted without penalty or payment.

Simpson certainly agrees with Senator McClure in his recognition of need for federal timber sale contract extensions. Extensions on timber sales which are not terminated is absolutely essential to West Coast timber purchasers. Unfortunately, extension alone, as applied to all timber sales, will not resolve the problem. The industry and the market could not possibly absorb the billions of board feet under contract bid at three to four times its current value. It must be recognized that regardless of the final decision on how the need for contract termination is resolved, adequate extension of contracts not terminated must be provided. We differ slightly from Senator McClure's proposal in that we recommend a contract term adjustment of five years for all timber sale contracts that remain in force after the termination process.

As you know, the forest industry is not unanimous on this issue. We are a large, diverse and highly competitive industry. Because of this fact, the burden of excessively priced federal timber does not fall equally on all producers or between regions. Many small and mid-sized producers in West Coast states which are dependent upon federal timber will suffer severe economic injury, if relief is not granted. Some of the producers which rely heavily on their own timberlands and state-owned timber for which relief has already been granted, have little interest in a contract relief program. But there is a concensus among the industry group seriously affected by this problem with agreement by many others in the forest industry.

As you consider this testimony and the testimony of others on timber sale contract relief issue, we ask that you keep in mind that federal timber purchasers requesting relief bid this timber based on federal policies in place at the time. There was no way a prudent purchaser could predict a drastic change in federal policies such as has recently occurred. Timber purchasers are the victims of the changed federal policies and like other contractors should be allowed contract adjustment when the terms and conditions are changed.

We appreciate the opportunity to submit this testimony. I can be available for further discussion or to answer any questions.

EDWARD HINES LUMBER CO.
OF OREGON

HINES PRECISION PRODUCTS

P. O. BOX 587

PONDEROSA PINE DIVISION
AREA CODE 503 - 573-2091

HINES, OREGON 97738

August 12, 1982

The Honorable Jesse A. Helms
United States Senate
4213 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Senator Helms:

We wish to inform you that on the subject of pending Federal timber sale relief legislation, our stand is as follows:

1. We support the concept incorporated into S. 2818 introduced by Senator James McClure. In final analysis, when the chips are down at the end of this season, the S. 2818 may become the final relief option. Its simplicity, granting upto a maximum of 5 years in contract term adjustments (CTA) for Federal timber sales under contract, should provide the equitability needed by all parties. The regulations granting these CTA's should also mandate a good faith plan by the recipients to start scheduled harvest of volumes of such extended contracts, as part of normal operations to be completed during the ensuing 5 years.

2. In its present format, we cannot support concepts in S. 2805, introduced by Senator Mark Hatfield. While it would provide needed, but inequitable, relief to Federal timber purchasers on the West Side through volume turn backs and/or reductions of speculatively bid stumpage prices, it would bring only minor relief for Pine Regions operations, where marginal and often negative stumpage prices prevail. The disproportionate relief favoring West Side of Region Six operations at the expense of Pine Regions purchasers is accented by lack of any provision in S. 2805 to make the deficits in Purchaser Credit road construction recoverable.

The compromise relief language that Senators McClure and Hatfield arrived at on July 14th, including a 40% volume turn back, 5 year timber sale contract extensions, and making all Purchaser Credits effective and recoverable, would have been reasonably equitable. Unfortunately, it appears to be unacceptable to folks outside of the Western timber industry.

Yours very truly

EDWARD HINES LUMBER CO. OF OREGON

Into Liimatta, Director
Planning & Public Affairs

II

97TH CONGRESS
2D SESSION

S. 2805

To provide for the orderly termination, extension, or modification of certain contracts for the sale of Federal timber, and for other purposes.

IN THE SENATE OF THE UNITED STATES

AUGUST 3 (legislative day, JULY 12), 1982

Mr. HATFIELD (for himself, Mr. PACKWOOD, Mr. JACKSON, Mr. GORTON, Mr. CRANSTON, and Mr. MURKOWSKI) introduced the following bill; which was read twice and referred jointly to the Committees on Agriculture, Nutrition, and Forestry and Energy and Natural Resources for not more than thirty days

AUGUST 4 (legislative day, JULY 12), 1982

Ordered further, if not reported within thirty days, the Committee on Agriculture, Nutrition, and Forestry be discharged

---

A BILL

To provide for the orderly termination, extension, or modification of certain contracts for the sale of Federal timber, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Congress finds that in order to avert widespread bankruptcies, sustain the flow of income from Federal forest lands to the Federal Treasury and to units of local government, and assist in restoration of employment, it is in the

national interest to provide for the modification of certain contracts for the purchase of timber from Federal lands.

SEC. 2. Upon a showing of economic hardship by the private contracting party, the Secretary of the Interior for public lands and the Secretary of Agriculture for national forest system lands are authorized to modify any timber sales contract bid prior to January 1, 1982. Such modifications may include—

(1) termination of a portion of timber sales contracts for the purchase of timber bid prior to January 1, 1982, held by a private contracting party;

(2) extension of the termination dates of such contracts, not to exceed five years beyond original termination dates of such contracts; and

(3) modification of the purchase price of the timber sold, reflecting current market values, for such contracts that are not extended.

SEC. 3. The Secretaries shall publish procedures for the modification of contracts pursuant to this Act in the Federal Register within thirty days after the date of enactment of this Act.

SEC. 4. The authority granted pursuant to this Act shall expire one year after the date of enactment of this Act.

II

97TH CONGRESS
2D SESSION

S. 2289

To provide for the future productivity of the national forest system.

IN THE SENATE OF THE UNITED STATES

MARCH 29 (legislative day, FEBRUARY 22), 1982

Mr. MELCHER introduced the following bill; which was read twice and referred to the Committee on Agriculture, Nutrition, and Forestry

---

A BILL

To provide for the future productivity of the national forest system.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Emergency National Forest Productivity Act of 1982".

SEC. 2. The Secretary of Agriculture shall establish a special program to remove dead, dying, diseased, and downed timber on national forest system lands. The purpose of this program shall be to make these lands more productive, through reforestation and other forms of enhancement, including road construction; to accomplish additional thinning and other forms of timber stand improvement; to reduce the

hazards of wildfire to accomplish more extensive yarding of undesirable materials; to provide employment in and around communities that are dependent on timber production; and to provide easier public access to firewood supplies.

SEC. 3. (a) The Secretary, in carrying out the purpose of this Act, may enter into contracts or other types of agreements with owners of private forest lands or other persons, or may conduct the work himself, if no contractors are available.

(b) The program to be carried out under the authority of this Act shall be judged by its contribution to the long-term productivity and environmental protection of the national forest system.

(c) Projects and other efforts established under the program authorized by the Act may be carried out in conjunction with projects, contracts, or agreements entered into under any authority which the Secretary may possess: *Provided*, That nothing contained in this Act shall abrogate or modify provisions of existing contracts or agreements, including contracts or agreements for the sale of national forest timber, except to the extent such changes are mutually agreed to by the parties to such contracts or agreements.

SEC. 4. The Secretary may carry out the special program through a procedure under which purchasers of national forest system timber under contracts awarded prior to October 1, 1986, may be required to remove residues and yard

undesirable materials, not purchased by them, to point of prospective use, in return for compensation in the form of residue removal credits. The residue removal credits shall be applied against the amount payable for the timber purchased, and shall represent the anticipated cost of removal. The following guidelines shall apply to projects carried out under this section:

(1) After the material removed from the forest is taken to points of prospective use, it shall be offered for sale at not less than its appraised value for commercial timber uses, such as lumber or pulp. Any wood material that is not sold for commercial purposes shall be offered for public use as firewood.

(2) Except in cases where wood is determined to be necessary for fire prevention, site preparation for regeneration, wildlife habitat improvement or other land management purposes, the Secretary may not provide for removal of wood material in instances where the anticipated cost of removal would exceed the anticipated value, including the estimated long term value of improved management of the national forest system.

(3) The residue removal credits authorized by this section shall not exceed the amount payable by the purchasers for timber after the application of all other charges and credits.

(4) Wood and wood residues shall be collected from a site so as to avoid soil depletion, erosion, and watershed damage, giving full consideration to the protection of wildlife habitat.

(5) For the purposes of the sixth undesignated paragraph under the heading "Forest Service" in the Act of May 23, 1908 (35 Stat. 260; 16 U.S.C. 500) and section 13 of the Act of March 1, 1911 (36 Stat. 963; 16 U.S.C. 500) (A) any residue removal credit applied under this section shall be considered as "money received" or "moneys received", respectively, and (B) the "money received" or "moneys received", respectively, from the sales of wood residues removed to points of prospective use shall be the proceeds of the sales less the sum of any residue removal credit applied with respect to such residues plus any costs incurred by the Forest Service in processing and storing such residues.

SEC. 5. The Secretary shall make annual reports to the Congress on the programs authorized by this Act. These reports shall be submitted with the reports required under section 8(c) of the Forest and Rangeland Renewable Resources Planning Act of 1974.

SEC. 6. The Secretary shall issue such regulations as the Secretary deems necessary to implement the provisions of this Act, within thirty days after enactment.

SEC. 7. There is hereby authorized to be appropriated not to exceed $150,000,000 for each of the fiscal years, 1983, 1984, 1985, and 1986 to (a) carry out the programs authorized under section 3 of this Act, (b) provide for the residue removal credits authorized by section 4 of this Act, and (c) carry out the other provisions of this Act. For the current fiscal year, the Secretary is authorized to transfer funds from other national forest system accounts to carry out the provisions of this Act.

SEC. 8. This Act shall become effective immediately.

○